BaFin

2016

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

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Opinion

BaFin President Felix Hufeld on low interest rates, digitalisation and regulation

2016 was dominated by three issues at BaFin, and they will continue to feature high on its agenda in 2017: continuing digitalisation, de-facto zero interest rates and the question of the right level of regulation. These issues have often enough been carried forward from one year to the next. Together, they pose a threefold challenge for the supervised undertakings – especially for banks.

Digitalisation and big data as an opportunity

Whether you tend to regard the increasing digitalisation of the financial sector as a destructive force or as an opportunity is a question of perspective, because digitalisation has a bit of both: it has its destructive elements, but – to quote loosely from Schumpeter – it's a creative destruction, one that can also offer opportunities and give rise to new things. That by no means suggests that the old, i. e. the established world of finance, is necessarily doomed to failure.

Yet digitalisation and big data are having an influence on the entire value chain of financial services. They may even break up this chain and reassemble it anew. There may also be links in the chain that will become obsolete in a few years' time. The question is what this creative destruction does to the business models of banks and insurers. Take insurers, for example: given the amount, range and quality of the data modern technology allows them to gather and analyse, they will in future be able to tailor their tariffs to individual customers with increasing precision. From a regulatory perspective, this is both sensible and desirable. Ultimately, however, big data could put the concept of the community of the insured to the test.

Old against new?

The catalysts of digitalisation are innovative fintech companies competing with the established companies in the financial sector. They use ultra-modern, flexible IT technology and put established providers under pressure in terms of offering and pricing. At the very least, this puts a question mark over existing business models. But even in the age of digitalisation, the banking and insurance business is based on trust, and fintech companies will first have to earn that trust. Meanwhile, established companies will require a degree of agility, and to demonstrate intelligence when making business decisions. As Ludwig Börne taught us,

in a rolling ship, he falls who stands still, not he who moves.

Data giants

This applies all the more in an environment of increasing competition: there are large firms outside the financial sector that hold huge amounts of customer data. In the future, these data giants could decide – as a sideline, effectively – to add financial services to their portfolio. Who and what offerings will prevail in the market in the coming decades will be decided by the market itself, i. e. the customer.

Supervision doesn't take sides

Supervision is impartial. It is without fear or favour. It applies its rules and standards appropriately to fintech companies, too, based on the old principle of "same business, same risks, same rules". What BaFin has made clear right from the start therefore continues to apply: its role is to supervise, not to boost the economy. Both functions are important and meaningful, but they should not be mixed. Fintech companies and the issue of digitalisation in general also pose challenges for BaFin. It has to get to the core of these issues and must not allow its knowledge to become outdated, because it is rightly expected to provide adequate answers to the regulatory and supervisory questions of digitalisation. Here, the watchword is "shape administrative procedures around target groups".

Cyber risk

This also, and in particular, applies to cyber risk, the dark side of digitalisation, where destruction is not coupled with creative benefits – not mentioning the illegal advantages cyber attackers seek to gain. Digitalisation creates a huge target. The business and value chain processes in the financial sector are heavily IT-dependent. For this reason, confidence in financial services providers today means above all confidence in IT security and the protection of personal data. To consider IT security purely from a cost perspective is therefore not only risky for operations, but also strategically short-sighted. True, to ensure sustained IT security is not an easy task – neither for established providers nor for fintech companies, incidentally. What's more, by its very nature, IT security is short-lived. What is considered secure today may become a gateway for cyber attacks tomorrow. But BaFin insists on sustained IT security and demands that undertakings also insist on such security from their IT service providers and suppliers. Both supervisors and the supervised undertakings must realise: there is no end to learning.

Low interest rates pose added challenge

In addition to the various challenges arising from digitalisation, there is another issue facing the sector: persistently low interest rates. Their effect is increasingly being felt – especially among those traditionally affected by them, such as life insurers in Germany. Most undertakings have prepared themselves well for continuing hard times on the interest rates front, for example by strengthening their capital base, cutting back discretionary bonuses and offering new products with new forms of guarantees. But the pressure, especially on weaker life insurers, is visibly mounting. They will have to make great efforts if they want to reliably keep paying the benefits they once promised in better times. Some owners may also have to get used to the fact that they will have to strengthen the capital of their undertakings. For BaFin, this means that it continues to operate – and increasingly so – in intensified supervision mode.

Pensionskassen and *Bausparkassen* in the low interest rate environment

This applies even more so to *Pensionskassen*, which are also struggling to cope with the low interest rates. They, too, started to take mitigating steps at an early stage in order to boost their risk-bearing capacity. Almost all *Pensionskassen* have recognised additional provisions. However, if the low interest rates persist, some of them may no longer be able to provide the promised benefits in full.[1]

It comes as no surprise that the low interest rates are also weighing on the earnings of

1 See chapter IV 2.4.5.

the *Bausparkassen*. One of the reasons is that interest expenses for *Bauspar* deposits dating back to periods of higher interest rates are not offset by similar interest income from *Bauspar* loans. The *Bausparkassen* are trying to deal with the consequences of this discrepancy. They are introducing new lower-interest tariffs, creating leaner processes and reducing their costs. The fact that they are also visibly working to reduce the proportion of high-interest-bearing *Bauspar* contracts in their portfolios has repeatedly caused a stir in the media. A recent court ruling has created greater clarity in this regard.[2]

Banks also increasingly affected

The longer the historically low interest rates continue, the more deeply felt their impact will be on the banks' books. In terms of capitalisation, German institutions are still in relatively good shape. But for how much longer? In times such as these, operating profitably becomes increasingly difficult, especially for banks that are primarily involved in the deposit-taking and lending business. The institutions are making the usual adjustments: cutting costs, introducing adequate prices, looking for new sources of income and revising their business models. A *tour de force*, especially in a banking sector that is as fiercely competitive as the one in Germany. But as I said earlier: those who don't move will fall. The trick is to make the right moves.

Interest rate risk

The longer interest rates remain low, the greater interest rate risk becomes for banks and insurers. All the more so, because in times of low interest rates banks are inclined to accept long-term loans and insurers favour extremely long-term investments. At the same time, the supervisory system requires that assets and liabilities are balanced appropriately. BaFin keeps an eye on these risks and intervenes where necessary.[3] In general, the regulatory community faces the issue of the unintended procyclical effect of financial regulation – in combination with international accounting standards as well.

Is regulation a burden?

Competition from fintechs and sluggish earnings because of low interest rates – banks in particular have for some time been complaining about another burden they'd love to eliminate: regulation. Let's take a quick look back: it's true that regulation has been tightened, and significantly so, since the outbreak of the financial crisis in 2007/2008. But it was with good reason, because large-scale deregulation had taken place in the years leading up to the crisis, and that had to be corrected.

There is no rule that says that regulation should be fun for the regulated. But there are rules in both German and European law that specify that it must be appropriate and must not be an excessive burden. In terms of proportionality, European bank regulation is not yet where it should be. As part of the reforms of the CRD IV and CRR[4], BaFin is therefore looking for ways to lessen the burden on smaller institutions. That this needs to be done is beyond doubt for BaFin, although it is far from clear to what extent it will be able to prevail in the European legislative process.

Navigating challenges

The process of reducing the burden on smaller institutions involves some challenges that have to be navigated carefully; for instance, banks can only fulfil their important economic role if they are sufficiently solvent and have adequate liquidity, and the banking system as a whole is stable and resilient. The capital and liquidity requirements, which were tightened following the crisis, must not be relaxed again – not even for smaller banks. The equation that "small equals low-risk" is in many cases a fallacy, and there have to be firm minimum standards for all banks. Consequently, concessions for smaller institutions should above all focus on areas where administrative effort can be minimised without reducing risk-bearing capacity.

2 See chapters I 5.3 and III 2.4.6.

3 See e.g. chapters I 5.2 and III 2.1.

4 Capital Requirements Directive IV and Capital Requirements Regulation.

Regulatory concessions that are a threat to financial stability must be off the agenda. This also and above all means that the particularly stringent requirements for large and systemically important banks must not be relaxed. Proportionality works both ways and must not be confused with laxity. In general, the reasonable and important objective to put greater emphasis on the principle of proportionality must not be confused with general deregulation. If there is one thing we have to prevent from happening, it is a relapse into the destructive "pork cycle" of deregulation-crisis-regulation-deregulation-new crisis. From a global perspective, such a relapse can by no means be ruled out at present. It is all the more important, therefore, to keep referring back to the lessons the financial crisis has taught us.

I Spotlights

1 Reform of the Basel framework

The member states of the Basel Committee on Banking Supervision (BCBS) are negotiating the finalisation of the Basel III reform agenda. Its key aspect is a review of global banking regulation, which in BaFin's opinion should also reflect the various national market structures and business models of the banks, despite its high level of detail. The crucial meeting of the Group of Central Bank Governors and Heads of Supervision (GHOS), originally planned for early January 2017, has been postponed, because some last important details still had to be clarified. The issue in question is the design and level of an output floor intended to limit the variability of risk-weighted assets (RWA) when using internal models. From BaFin's point of view, the aim has to be to find an acceptable global compromise and thus bring Basel III to a successful conclusion.[1] However, a compromise at any price is, in the opinion of BaFin's President Felix Hufeld, not an option. He believes that it is correct to limit the risk sensitivity of the Basel framework and therefore also the use of internal models in a reasonable way. "But we are not prepared to, *de facto*, relinquish risk sensitivity as a regulatory principle."

2 Important European reforms

2.1 Commission's reform package

2.1.1 Banks

Since the start of the financial crisis in 2007/2008, banking regulation has been significantly tightened – at both the global and the European level. In 2016, the European Commission dealt intensively with the issue of whether post-crisis regulation is adequate and at the same time proportionate. At the end of November 2016, it presented a comprehensive package of reform proposals intended to further

1 No results were available at the time of going to press.

Planned amendments

The European Commission aims to reduce risks and thus increase financial stability and strengthen the trust in the European banking sector. To this end, the Commission intends to make additions in particular to the Capital Requirements Regulation (CRR) and the Capital Requirements Directive IV (CRD IV) as well as the Bank Recovery and Resolution Directive (BRRD) and the Single Resolution Mechanism Regulation (SRMR).

complete the regulation of the financial markets and also improve proportionality at the same time (see info box "Planned amendments").

2.1.2 Capital markets

The Capital Markets Union project, which the European Commission launched with an action plan in 2015 and which is intended to create a single EU market for capital, made further progress in 2016. A number of the 33 actions and individual measures contained in the Commission's action plan are about to be concluded. The Commission is expected to publish a mid-term review of the project in June 2017, based on a public consultation process running until March. All the planned actions are to be finalised by 2019.

In particular, the Commission aims at greater involvement of institutional and private investors in the long-term financing of companies and infrastructure projects. In addition to traditional bank financing, capital-market-based financing instruments and access to equity and risk capital are to be promoted. The aim is to invigorate the European securitisation market and to make it more robust, in particular by introducing simple, transparent securitisations (STS) as a new product. Deeper, more closely integrated and more liquid markets are intended to provide a larger portfolio of financing sources to the real economy and expand the investment horizon for investors. The project is a key component of the Investment Plan initiated by the European Commission in order to create more jobs and generate growth in the EU.

Germany provides constructive feedback and support on the action plan. Elisabeth Roegele, Chief Executive Director of Securities Supervision, believes that efforts will have to be made in many areas to ensure that all measures, which might be amended or expanded in the light of fresh challenges, are completed on schedule. "But if the outcome is the promotion of an investment-friendly environment, these efforts should ultimately pay off – for investors as well as for companies that require capital in order to expand and create jobs."

3 Verdict: one year of Solvency II

Solvency II, the regulatory framework for insurance supervision, entered into force at the beginning of 2016. Its aim is to make risks more transparent and thus easier to manage. The system got off to a successful start and insurers are gradually learning how to deal with it. But despite the extensive preparations, the framework continues to pose challenges for both undertakings and BaFin. "Additional factors are the difficult market conditions – 'low interest rate environment' is a key term here – and the requirements of the additional interest provision, the '*Zinszusatzreserve*' (ZZR)", explains Dr Frank Grund, Chief Executive Director of Insurance and Pension Funds Supervision. "BaFin is keeping a close watch on this difficult situation and will intervene if necessary."

In the summer of 2016, BaFin presented initial figures on the respective insurance classes the undertakings had reported under the new reporting system. Pursuant to section 89 of the German Insurance Supervision Act (*Versicherungsaufsichtsgesetz*), which implements Solvency II in Germany, insurers must at all times have eligible own funds equivalent, as a minimum, to their solvency capital requirement (SCR).

The analysis of the day 1 reporting revealed that – with few exceptions in property and casualty insurance – all insurers were able to meet the new solvency capital requirements adequately. Among life insurers, the SCR ratios varied widely due to the difficult capital market environment, but reached their highest levels at the end of the fourth quarter. By contrast, the SCR coverage ratios for providers of private health insurance remained largely stable for the whole of 2016. After a decline in the second quarter, the SCR ratio again approached its starting level towards the end of the fourth quarter. The ratios in the property and casualty insurance and the reinsurance business proved relatively steady. Because of high volatility levels attributable to changing market conditions, a simple comparison of the SCR coverage ratios should be considered with caution.

With Solvency II, supervision moves away from purely rules-based towards more principles-based supervision – with all the challenges this kind of supervision entails, including for the undertakings. The interpretative decisions BaFin has taken to date have provided the necessary guidance to insurers. The insurance supervisors intend to continue this process.

4 Verdict: two years of European banking supervision

The eurozone's Single Supervisory Mechanism (SSM) for banks celebrated its second birthday in November 2016 (see info box "Supervision in the SSM" on page 19). The integration of European banking supervision has been and still is a project of historic proportion, which continues to pose major challenges for the European Central Bank (ECB) as well as the 19 participating supervisory authorities. The SSM has got off to a good start, but it hasn't got to where it should be yet, says Raimund Röseler, Chief Executive Director of Banking Supervision. "Of course it will still take some improvements to achieve the objective of standardised and efficient banking supervision."

One of the key challenges will be to revise the governance system, with particular emphasis on optimising the decision processes and allocating responsibilities. Currently, all major decisions in the SSM have to be taken by the 25 voting members of the Supervisory Board, the SSM's highest body. In addition, they have to be approved by the ECB's Governing Council. Given the multitude of different issues – more than 2,000 decisions have to be taken each year – this is not effective and entails unnecessary administrative effort. The Supervisory Board should rather focus on critical decisions that are of fundamental importance. BaFin therefore supports the efforts to delegate more competences to the working level.

Supervision in the SSM

Under the leadership of the European Central Bank (ECB), the Single Supervisory Mechanism (SSM) directly supervises the eurozone's approximately 130 significant institutions (SIs) or groups of institutions. The national competent authorities are part of the SSM. The so-called less significant institutions (LSIs) are supervised by the ECB indirectly; they continue to be subject to national supervision. The approximately 1,600 LSIs in Germany are supervised by BaFin with the support of the Deutsche Bundesbank. In principle, the SSM can also be joined by EU member states that are not part of the eurozone.[2]

5 Low interest rates

5.1 Insurers

The persistently low interest rates are increasingly weighing on insurers, especially life insurers. The sector has prepared for a continuation of depressed interest rates in the short term. The undertakings have strengthened their equity bases, cut their discretionary benefits and offer products with new types of guarantees. Yet some life insurers are increasingly coming under pressure, and BaFin is therefore supervising them with particular attention.

New kinds of guarantees

Long-term contracts with guaranteed interest continue to be a focus of new business at German life insurers. To date, the most significant product category has been deferred annuity insurance with life-long guarantees of the applicable maximum technical interest rate as well as annual increases in the guaranteed benefits by way of profit participation. In the current low interest rate environment, these kinds of guarantees pose a significant risk to life insurers. For several years, the undertakings have therefore increasingly been promoting products with new types of guarantee mechanisms. For example, the guarantees may be based to a greater extent on a bullet payment at maturity, they may be recalculated at the commencement of the annuity, or cover only the sum of the contributions made.

Pensionskassen in the low interest rate environment

The low interest rates are increasingly having a negative impact, particularly on *Pensionskassen*, whose business model is based on a long-term view. BaFin therefore monitors them closely, too, so that the undertakings maintain and further strengthen their risk-bearing capacity as far as possible. The *Pensionskassen* have already taken early steps in this regard, as evidenced by BaFin's projections. Almost all *Pensionskassen* have recognised additional provisions. However, if the low interest rates persist much longer, it is expected that some *Pensionskassen* may no longer be able to provide the promised benefits in full from their own resources. If it comes to that, the appropriate response in the case of *Pensionskassen* organised as mutual insurance associations (*Versicherungsverein*) would be that funds are provided by their owners; in the case of stock corporations, this would be the shareholders' responsibility.

5.2 Banks

The extended duration of the low interest rate environment is having an increasingly significant impact on the banks' books as well. The capital resources of German institutions are still relatively sound, but the longer

2 The current list of all significant institutions under direct SSM supervision can be found at https://www.bankingsupervision.europa.eu. The significant German institutions under direct SSM supervision are listed in Table 31 (Appendix, page 221).

interest rates remain low, the more difficult it will become for the institutions to generate adequate income and to maintain a sufficient capital buffer in the long run. In many cases, this can only be achieved through increased maturity transformation. This applies above all to banks that operate primarily in the deposit and lending business.

Interest rate risk

What is more, the longer interest rates stay low, the greater the banks' interest rate risk in the banking book (IRRBB) will become as a result of the increased maturity transformation. Again, this hits institutions with a broad customer base in the deposit and lending business particularly hard. Significantly more than 50 % of all credit institutions face increased interest rate risk – and the trend is rising.

Pillar I of the regulatory framework does not currently specify general capital requirements for interest rate risk in the banking book. In 2016, BaFin therefore began, as part of the Pillar II supervisory review and evaluation process (SREP), to examine whether the approximately 1,600 institutions under its direct supervision have set aside sufficient own funds to allow them to cushion this and other risks.

BaFin subjected the first 319 banks to the SREP process in 2016. Banks that received a SREP notice by the end of 2016 will have to increase their own funds by an average of 0.89 percentage points for interest rate risk in the banking book. To ensure equal treatment, institutions that were not notified of their capital requirement by BaFin in 2016 are required as from 1 January 2017 to cover at least the IRRBB quantified by BaFin. The legal basis for this is provided by a general administrative act of 23 December 2016, which has been in force since the beginning of 2017. As soon as one of the banks receives a final SREP notice with its individual capital requirement, the general administrative act will cease to apply to this bank.

5.3 *Bausparkassen*

The low interest rates are also having a major negative impact on the earnings situation of the *Bausparkassen*. One reason is that there is no corresponding interest income from *Bauspar* loans to offset the interest expenses on *Bauspar* deposits paying a comparatively high rate of interest. However, an amended *Bausparkassen* Act (*Bausparkassengesetz*) came into effect at the end of 2015. It helps the *Bausparkassen* to lessen the consequences of low interest rates for the long term.

In 2016, the *Bausparkassen* continued their attempts to deal with the consequences of the low interest rate environment. As in previous years, they introduced new lower-interest tariffs, created leaner processes and reduced their costs.

In addition, the *Bausparkassen* are also continuing their efforts to reduce the proportion of high-interest *Bauspar* contracts in their portfolio. This was made clear by the many terminations again announced by *Bausparkassen* in 2016, relating to *Bauspar* contracts that are over-saved or have been eligible for allocation for more than 10 years. The prevailing opinion of the courts is that the termination of over-saved building savings contracts is permissible.

On 21 February 2017, the Federal Court of Justice (*Bundesgerichtshof* – BGH) ruled in principle that *Bausparkassen* may terminate *Bauspar* contracts that have been eligible for allocation for at least 10 years without the savers having taken out the allocated loan. Allowing a *Bauspar* contract to run for more than 10 years simply as a savings account was in conflict with the meaning and purpose of *Bauspar* plans, according to the Court's decision.

6 Consumer protection

The protection of consumers collectively has been one of BaFin's responsibilities for a number of years. Since 2015, BaFin's supervisory objective of collective consumer protection has also been laid down in law. In order to meet this objective, BaFin established a department for issues relevant to consumer protection at the beginning of 2016.

No patronising

In principle, consumers should be able to act under their own responsibility and take decisions on the basis of adequate information without being told what to do. For this reason, BaFin campaigns for a transparent, comprehensible offering of financial and insurance products and financial services. The information that providers make available – whether in compliance with legal requirements or on a voluntary basis – must be presented in such a way that it meets the needs and knowledge requirements of consumers. This is the only way the knowledge gap between consumers and providers can be closed.

In addition, BaFin proactively raises awareness of the different types of financial and insurance products and financial services and the risks associated with them – for example on its website, www.bafin.de, in the BaFinJournal, in brochures as well as at trade fairs and *Börsentage*.

New instruments

If adequate collective consumer protection cannot be provided by requiring transparency, providing information and raising awareness alone, BaFin uses its new supervisory instruments for preventing and correcting deficiencies laid down in the German Retail Investor Protection Act (*Kleinanlegerschutzgesetz*). They allow it to issue orders to prevent or remedy deficiencies related to consumer protection if general clarification is called for in the interest of consumer protection. In serious cases, it can even restrict or altogether prohibit the distribution of products or certain sales practices – notably in cases where investor protection or the proper functioning or integrity of the financial markets is at risk.

For example, in summer 2016, prompted by its own market investigation, BaFin considered the prohibition of the distribution of what have up until now been referred to as credit-linked notes. These types of notes are highly complex products: the interest rate and repayment of the cash amount invested are dependent on the credit risks of the reference company. It is normally difficult for retail clients to estimate whether a credit event will occur in relation to the underlying reference liability. The associations of the affected issuers and distributors responded to the planned prohibition with a comprehensive voluntary undertaking. On this basis, BaFin announced in December 2016 that it would postpone its planned ban and examine the effect of the voluntary undertaking.

In the middle of December, BaFin announced its intention to impose restrictions on the marketing, distribution and sale of contracts for difference (CFDs) in order to protect retail investors. The sale to retail clients of contracts entailing an obligation to make additional payments should then no longer be permitted, because they are unable to calculate the risk of loss. If the difference the investor has to settle exceeds their invested capital, they have to settle the difference from their other assets. Comments on the relevant draft general administrative act could be submitted until 20 January 2017. No decision had been taken on this issue by the time of going to press.

7 Digitalisation and fintech companies

The financial sector is undergoing radical change, driven primarily by digitalisation. Companies with innovative technology-driven business models – so-called fintech companies – are pushing onto the market and pose a challenge to established companies (see info box "The BaFin fintech project"). However, even the established companies are increasingly using digitalised processes. They are forging alliances with fintech companies, draw inspiration from their models, or develop their own ideas.

Thanks to the large data volumes that can now be collected and analysed, insurers can tailor their tariffs to customers with increasing precision. However, the digital revolution also spans technological innovation in payment transactions, crowdfunding, automated financial advice, comparison services platforms and virtual currencies, all of which hold opportunities as well as risks. Security, in the sense of protection against cyber attacks, is therefore an important issue for fintechs and established companies. The threat of these types of attacks increased again in 2016.

Regulation of fintech companies

Whether and in what way fintech companies are regulated depends on the business model they follow, based on the principle of "same business, same risk, same rules". Once a fintech company has entered regulated territory, it will be supervised by BaFin in the same way and according to the same rules as established companies – following the principle of proportionality. In this process, BaFin tries to pursue a technology- and innovation-friendly administrative practice, for example by communicating clearly and promptly. BaFin has no mandate to stimulate economic development – to avoid potential conflicts of interest, among other reasons.

Information tailored to affected companies

Start-ups and fintech companies have, for some time now, been able to contact BaFin by using a special online form. To make it easier for companies to familiarise themselves with supervisory issues, the BaFin website provides compact, easy-to-follow information on a number of fintech business models that is specifically tailored to fintech companies. BaFin also supports direct dialogue by attending various events. In June, it hosted its own conference, BaFin-Tech 2016.

The BaFin fintech project

At the beginning of 2016, BaFin established a fintech project group; as at 1 January 2017, its responsibilities were transferred to an organisational unit in the President's Directorate specifically set up for the purpose.

8 Brexit

On 23 June 2016, the citizens of the United Kingdom voted in a referendum, which returned a slim majority in favour of leaving the European Union (EU). Although the Brexit vote caused significant price and exchange rate fluctuations on the following day, calm quickly returned to the markets. The longer-term economic impact of Brexit on trade links with Continental Europe will depend on the upcoming exit negotiations.

A large number of companies under UK supervision – including many subsidiaries of major non-European banks – are using the European passporting rights to offer banking and other financial services in other EU member states. At the end of 2016, approximately 140 UK companies from all supervised financial sectors conducted their business through a branch in Germany. An even larger number provide cross-

Brexit workshop with foreign banks

Acting on the initiative of President Felix Hufeld, BaFin invited around 50 representatives of foreign banks to a workshop held in Frankfurt on 30 January 2017 to exchange views on supervisory issues relating to Brexit. The event focused on topics such as risk management, compliance, outsourcing, internal models, rules for large exposures, recovery planning and authorisation proceedings under the German Banking Act (*Kreditwesengesetz*).

Department head Dr Peter Lutz said after the discussions: "For us as committed Europeans, Brexit is not a reason to celebrate. But we have to be pragmatic now and give institutions the supervisory clarity they need in taking their strategic decisions." BaFin was doing this, he said, to provide a reliable basis for the activities of companies wishing to relocate their business to Germany as well as to ensure that no threats arise for the German financial sector. In this respect, he saw a special role for BaFin as the integrated German financial supervisor, since it monitors the whole of the financial market. BaFin will continue to make itself available for future consultations.

border services, with over 2,700 companies using the services passport. Depending on the type of Brexit deal, the passporting rights may no longer be available in future, prompting the affected companies to consider relocating their registered offices to other financial centres within the European Union.

BaFin is ready to deal with queries in this regard and is also actively approaching interested undertakings, for example, by offering workshops (see info box) or individual consultations. As the German Supervisory Authority, it aims to offer the undertakings clarity and support, as well as a reliable framework that allows them to provide financial services even under the new political conditions.

To this end, BaFin provides the relevant information on its website. A special e-mail address (access@bafin.de) and a contact form have also been set up. All communication may be conducted in English. BaFin will respond to all queries within two working days and guarantees that issues will be processed quickly and efficiently.

9 Timeline of important events in 2016

January	▸ The new European framework for insurance supervision, **Solvency II**, enters into force. ▸ BaFin's new **Consumer Protection** Department starts its work. ▸ BaFin publishes new editions of its **Guidance Notice** on **management board members** pursuant to the German Banking Act (*Kreditwesengesetz* – KWG), the German Payment Services Supervision Act (*Zahlungsdiensteaufsichtsgesetz* – ZAG) and the German Investment Code (*Kapitalanlagegesetzbuch* – KAGB) and its Guidance Notice on members of administrative and supervisory bodies pursuant to the Banking Act (*Kreditwesengesetz* – KWG) and the Investment Code (*Kapitalanlagegesetzbuch* – KAGB). ▸ The Basel Committee on Banking Supervision (BCBS) publishes a fundamentally revised **framework for market risk capital requirements**. ▸ BaFin – in consultation with the European Central Bank (ECB) and still under the transitional provisions (*Übergangsregelung*) – grants banking authorisation to **EIS Einlagensicherungsbank GmbH**, Berlin. The institution, a joint venture of the Association of German Banks (*Bundesverband deutscher Banken*) and the Auditing Association of German Banks (*Prüfungsverband deutscher Banken*), has been established to improve the responsiveness of private deposit protection in cases where an institution protected by the deposit protection fund is at risk of getting into financial difficulties.
February	▸ The **Insurance Distribution Directive** (IDD) enters into force; it has to be transposed into national law by 23 February 2018. ▸ BaFin issued a ban on disposals and payments (moratorium) for **Maple Bank GmbH** because of a threat of excessive balance-sheet debt. Shortly afterwards, it files an application to initiate insolvency proceedings and then also determines that a compensation event has occurred. ▸ The intention of **Deutsche Börse AG** and the **London Stock Exchange Group** to merge under a joint holding company (HLDCO123 PLC) is made public in an ad hoc disclosure published by Deutsche Börse AG.
March	▸ The ECB cuts the **interest rate for main refinancing operations** from 0.05 % to 0 %. At the same time, it lowers its rate for the marginal lending facility from 0.3 % to 0.25 % and the deposit facility rate from –0.3 % to –0.4 %. ▸ The German Act Implementing the **Mortgage Credit Directive** (*Gesetz zur Umsetzung der Wohnimmobilienkreditrichtlinie*) enters into force. The amendments to, among other laws, the German Civil Code (*Bürgerliches Gesetzbuch*) and the Banking Act, are intended to give consumers the best possible protection when buying residential property. ▸ The European Commission publishes a delegated regulation, which sets out, among other things, detailed requirements for the contents and supervisory assessment of **recovery plans** and the conditions for **intragroup financial support**. ▸ The **ECB** publishes its regulation on the exercise of **options** and **discretions** available in Union law as well as a guide on harmonising options and discretions in banking supervision. ▸ Under its Financial Sector Assessment Program, the International Monetary Fund (IMF) also scrutinises BaFin's work (**FSAP assessment**) in February and March.

April	▸ The BCBS publishes the revised framework for the treatment of **interest rate risks in the banking book**. ▸ The BCBS publishes a revised version of the **leverage ratio** framework. ▸ BaFin issues a regulation detailing requirements for the expertise of employees engaged in the granting of **consumer loans for immovable property**.
May	▸ The first Supervisory Review and Evaluation Process (**SREP**) for less significant institutions (LSIs) is launched, with over 300 LSIs coming under scrutiny. At the end of July/beginning of August, BaFin sends out the first SREP notices stipulating an individual capital add-on. ▸ The European Commission publishes a delegated regulation setting out the criteria for determining the minimum requirement for own funds and eligible liabilities (**MREL**).
June	▸ The provisions of the German Payment Accounts Act (Zahlungskontengesetz) relating to the **basic payment account** enter into force. It gives every consumer the right to open an account with basic functions (basic payment account). BaFin is mandated to enforce, upon request, the institutions' obligation to contract. ▸ The obligation to clear certain **interest rate derivatives** against a central counterparty enters into force for larger market participants that already belong to a central counterparty. In 2017, this obligation will be gradually extended to other products and smaller market participants. ▸ In a referendum, the British people vote with a slim majority for the United Kingdom to leave the European Union (**Brexit referendum**). ▸ BaFin publishes FAQs on investing own funds in accordance with section 25 (7) of the Investment Code; the catalogue is continually updated. ▸ The effective date of the **European Markets in Financial Instruments Directive II (MiFID II)** and of the Markets in Financial Instruments Regulation (MiFIR) is postponed by one year to 3 January 2018. The EU member states' implementation deadline for MiFID II is extended to 3 July 2017.
July	▸ The first parts of the German First Financial Markets Amendment Act (*Erstes Finanzmarktnovellierungsgesetz*) enter into force. ▸ BaFin establishes a central contact point for **whistleblowers**, which can be used to report violations of supervisory requirements. ▸ The **Market Abuse Regulation** (MAR) is now fully in force in all EU member states. The MAR has resulted in changes to the provisions governing the ban on market manipulation and to insider law. In addition, the MAR has tightened the sanctions regime. ▸ BaFin publishes initial figures on **Solvency II**, based on data supplied by insurance undertakings as at the beginning of the year (day 1 reporting) and on the quantitative reports for the first quarter. ▸ The BCBS publishes its revised **securitisation framework**, which comprises capital requirement rules for simple, transparent and comparable securitisations. ▸ BaFin publishes a general administrative act on the submission of supervisory **financial information** in accordance with Regulation (EU) No 2015/534 of the ECB.

	▸ BaFin begins the hearings phase relating to a planned prohibition on the marketing, distribution and sale, to retail clients, of what have up until now been referred to as **credit-linked notes**. The associations of the affected issuers and distributors take this opportunity to publish a comprehensive voluntary undertaking on 16 December 2016. In response, BaFin announces that it will suspend its planned ban and examine the effect of the voluntary undertaking. ▸ The European Banking Authority (EBA) publishes the results of its **Europe-wide stress test**. A total of 51 institutions took part in the EBA stress test, including nine German institutions. ▸ Two German central cooperative banks, **WGZ Bank AG** and **DZ Bank AG**, merge into DZ Bank AG, now Germany's third largest commercial bank.
August	▸ BaFin submits the German **Remuneration Ordinance for Institutions** (*Institutsvergütungsverordnung*) and the associated interpretive guidance for consultation.
September	▸ The restructuring of two major German energy utilities, E.ON SE and RWE AG, leads to the IPOs of **Uniper SE** and **innogy SE**. ▸ The provisions of the German **Payment Accounts Act** relating to help with switching account enter into force. ▸ BaFin amends the German **Solvency Regulation** (*Solvabilitätsverordnung*) for banks to bring it in line with the ECB regulation on options and discretions.
October	▸ The EBA publishes guidelines on implicit support for **securitisation transactions**. ▸ The European Commission publishes implementing regulations laying down implementing technical standards for the allocation of **credit assessments** of external credit assessment institutions to supervisory quality steps.
November	▸ In November and December, BaFin organises a total of four **workshops** on the transparency requirements under the **MAR**. The workshops are aimed in particular at issuers admitted to trading on multilateral trading facilities (MTFs). ▸ The **Financial Stability Board (FSB)** again designates **nine insurance groups** as **global systemically important** institutions. ▸ The **European Commission** publishes a **reform package** with proposed legislation intended to strengthen the resilience of banks and to reduce risks in the banking sector. ▸ The European Commission publishes proposed legislation for the recovery and resolution of **central counterparties**.
December	▸ The Federal Republic of Germany assumes the chairmanship of the Group of Twenty (G20). ▸ The obligation to use **key information documents** for packaged retail and insurance-based investment products (**PRIIPs**) pursuant to the PRIIPS Regulation is postponed by one year to 1 January 2018. ▸ The European Parliament, the European Council and the European Commission reach agreement on the new **Prospectus Regulation**.

- BaFin submits for consultation the draft of a planned general administrative act, which it intends to use to **restrict** the marketing, distribution and sale of contracts for difference (**CFDs**). To ensure the protection of retail clients, offerings for these clients will only be allowed to contain product variants that do not entail an obligation to make additional payments.
- The amendments to the German **Reports Regulation** (*Anzeigenverordnung*) enter into force. The regulation thus reflects, among other things, the amended provisions under EU law and the resulting modifications to the German Banking Act and the ECB's function as a supervisory authority.
- The European Insurance and Occupational Pensions Authority (EIOPA) publishes its **final report** on the **2016 Europe-wide stress test** for insurance undertakings. The results confirm BaFin's assessment of the effects the persistent low interest rate environment is having on German life insurers.
- A **report** by the **Joint Committee** of the three European Supervisory Authorities on reducing reliance on credit ratings is addressed to the national competent authorities, which supervise the users of credit ratings. The report is intended to contribute to ensuring that the **EU Credit Rating Regulation** is interpreted consistently throughout Europe.
- Based on its investigation of **closet indexing**, BaFin intends to impose greater **transparency** requirements on the fund industry. To this end, it submits for consultation a draft publication on the inclusion of additional disclosures in prospectuses for retail funds.
- The Federal Cabinet adopts the draft of the **German Occupational Pensions Reform Act** (*Betriebsrentenstärkungsgesetz*), thus initiating a comprehensive package of measures to expand occupational retirement provision.
- The Act Amending the Insolvency Code and Amending the Act Introducing the Code of Civil Procedure (*Gesetz zur Änderung der Insolvenzordnung und zur Änderung des Gesetzes betreffend die Einführung der Zivilprozessordnung*) is promulgated in the Federal Law Gazette. In response to a decision of the Federal Court of Justice (*Bundesgerichtshof*) of 9 June 2016, legislators amended section 104 of the German Insolvency Code (*Insolvenzordnung*) to the effect that **netting clauses** can be agreed again that are protected against insolvency and also meet the requirements for supervisory recognition, in particular pursuant to the Capital Requirements Regulation (CRR).
- The new Directive on the activities and supervision of institutions for occupational retirement provision (**IORP II Directive**) is published in the Official Journal of the EU. It contains more detailed rules on corporate governance and on the information requirements to beneficiaries than the previous directive.
- An **amendment** to the Act Establishing the Federal Financial Supervisory Authority (Gesetz über die Bundesanstalt für Finanzdienstleistungsaufsicht – FinDAG) enters into force. The catalogue of costs to be reimbursed separately by the affected institutions included in section 15 of the Act Establishing the Federal Financial Supervisory Authority is expanded: it now also comprises the costs of BaFin and the Bundesbank if incurred as a result of an examination ordered by the European Central Bank. This means that the ECB does not bill for these costs directly.

- BaFin issues a general administrative act for capital requirements relating to **interest rate risk** in the banking book that has not yet been considered in the SREP process.
- The German Act for the Reorganisation of the Functions of the Financial Market Stabilisation Agency (*Gesetz zur Neuordnung der Aufgaben der Bundesanstalt für Finanzmarktstabilisierung* – **FMSA Reorganisation Act**) is promulgated in the Federal Law Gazette. It governs the incorporation of parts of the FMSA into BaFin. On 1 January 2018, BaFin will take on the functions of the national resolution authority from the FMSA, which is the competent authority until then. The remaining part of the FMSA performing the functions in connection with the management of the Financial Market Stabilisation Fund (*Finanzmarktstabilisierungsfonds* – FMS) will be integrated into the German Finance Agency.

II Integrated supervision

1 Consumer protection

1.1 Discussion topic: Cost transparency and product governance

1.1.1 Opinion

Elisabeth Roegele on product governance

"Product oversight and governance" (POG) is a collective term applied to a raft of new regulations affecting almost the entire financial sector. By implementing POG, European legislators have brought about a paradigm shift, because in the past customer-related organisational requirements and investor protection arrangements were primarily focused on the distribution process and the timing of providing a service to the customer. The new standards track the entire lifecycle of the financial products concerned, from the cradle to the grave: from product manufacture through product observation after distribution to the end of the product's life, for example when it is redeemed or matures.

Elisabeth Roegele

is Chief Executive Director of Securities Supervision/Asset Management.

The POG issue has received the most comprehensive treatment so far in securities regulation, namely in MiFID II[1], the revised version of the Markets in Financial Instruments Directive, which will have to be applied as from 3 January 2018. MiFID II, where the term has been shortened to product governance, contains a large number of requirements for financial instruments and structured deposits.

Commitment to greater investor protection

By including the product governance requirements in Article 16(3) and Article 24(2) of MiFID II, European legislators have committed themselves to a significant boost in investor protection. German legislators had already anticipated some of these requirements in the German Retail Investor Protection Act (*Kleinanlegerschutzgesetz*) of July 2015. The entire package of European regulations will now – to the extent required – be transposed into German law by way of the German Second Financial Markets Amendment Act (*Zweites Finanzmarktnovellierungsgesetz*). Manufacturers and distributors of financial products will have to implement the relevant processes in future.

Customer interests as a benchmark

MiFID II makes customer interests a key benchmark by which a product and the accompanying distribution strategy will have to be measured in future. Whether customer interests are satisfied will, however, depend on many different, sometimes variable, factors, such as the target group and the current market situation. What is more, customer interests can only be comprehensively safeguarded if they are taken into account during both manufacturing and distribution of the product and if manufacturing and distribution are coordinated and dovetail into each other. This means that not only the product approval process at the manufacturer, but also the equivalent process for including the product in the product universe of a distributor will have to feature a large number of process steps that can help to ensure that customer interests are safeguarded and the product is suitable for the needs of the respective customer group. Additional requirements are an observation process to keep continuous track of the development of the product as well as a review process that can be used subsequently to adjust products and distribution strategies, if necessary.

Product approval process

Specifically, the product governance requirements mean that manufacturers under the scope of MiFID II will in future have to set up a product approval process, which will have to be regularly reviewed. Products must not be approved for distribution without having passed through this process. Another objective of the process is to ensure that the manufacturers adequately understand and take account of the features and risks of the products they manufacture and their significance for the end customer. In addition, the product approval process is aimed at making management take greater responsibility for their firms' own products. This is made possible, for example, by reserving key decisions within the process for executive management.

Identifying the target market

The core element of the product approval process is to identify a target market for the product before distributing it to end customers. To this end, the end customers' investment objectives and their ability to bear potential losses are among the factors to be taken into account. Moreover, all the relevant risks associated with the product must be assessed, especially the risk of loss or default and the risk of fluctuations in value. The investment firm also has to ensure that the planned distribution strategy is suitable for the target market. The requirement to identify the target market is intended to make manufacturers and distributors rethink some of their approaches. It also goes without saying that both manufacturers and distributors want to generate profit, and quite legitimately so. However, the purpose of making them focus on the target market is to prevent these interests from dominating the product manufacturing process to such an extent that they lose sight of the interests of end customers.

1 Markets in Financial Instruments Directive. Directive 2014/65/EU, OJ EU L 173/349.

Since the customers for whom the product is intended will in future have to be specified at the beginning of the manufacturing process, their needs will be given special weight.

Convergence in Europe

In order to guarantee Europe-wide convergence in the application of these requirements, the European Securities and Markets Authority (ESMA) issued draft product governance guidelines in October 2016[2], providing more detailed information on the set of obligations manufacturers and distributors face with regard to the target market. According to these guidelines, manufacturers have to assess the target market at least on the basis of the following six categories, although the level of detail of the assessment may vary, depending on the complexity of the product and the planned channel of distribution: The categories to be included are the type of client – retail client, professional client or eligible counterparty –, knowledge and experience, the client's financial situation and their ability to bear potential losses. In view of the risk/reward profile of the product, the target client's risk tolerance must also be determined. Finally, the minimum criteria also include the end client's investment objectives and needs. A possible example would be an investor wanting to arrange their retirement provision using ethical investment products.

Identifying the distributor's target market

In order to achieve the required integration between product manufacturing and distribution, manufacturers will in future be obliged to provide information gained during their product approval process – especially on the target market – to the distributors. Distribution firms will be expected to critically examine the target market specified by the manufacturer, define it on a more concrete level on the basis of their customer base, and then implement it in practice. This means that, apart from specifically justified exceptional cases, they will be expected to market a product only to customers identified as target customers. In addition to the suitability assessment required at the investment advice stage or the appropriateness test that is necessary for more complex products in the non-advised business, the distributor will therefore have to establish for its client whether they belong to the target market identified.

The identification of the target market as a core element of product governance was so important to European legislators that they have extended it to products that are not subject to the manufacturer requirements of MiFID II. For these cases, legislators have assigned a kind of fall-back responsibility to distributors that cannot access information from the manufacturer's approval process in those instances: if a distributor wants to offer products for which the manufacturer has not specified a target market, because the manufacturer is not subject to the provisions of MiFID II or the German Securities Trading Act (*Wertpapierhandelsgesetz* – WpHG), the distributor is required to determine the target market independently. If a third-country manufacturer fails to provide the necessary information, it could, for example, be obtained from reliable, publicly accessible sources, such as the securities prospectus. This could be a conceivable solution in the case of shares or corporate bonds issued in a third country that are to be traded in Europe in an execution only transaction.

Product monitoring obligations during the entire lifecycle

The new product governance rules entail monitoring obligations for manufacturers and distributors for the entire lifecycle of a product. This means that responsibility for the product does not end at the point of sale, but will in future extend to any consequences for investors and the financial system that arise from manufacturers and distributors having jointly launched a product. The aim of the monitoring obligations is to allow companies to detect at an early stage if product features in their market and customer environment develop counter to clients' interests.

2 Consultation Paper on Draft guidelines on MiFID II product governance requirements (as amended at the time of going to press).

Since effective monitoring is only possible with the requisite information about the product, another focus of the new requirements is on the communication processes between manufacturer and distributor. This means on the one hand that distributors receive the manufacturer's information from the product approval process. On the other, they send information suitable for product monitoring back to the manufacturer (e. g. experience made with the product, any complaints received, extent to which target market has been reached). If this exchange of information or the manufacturer's or distributor's own analyses give rise to relevant changes that could have a negative impact on products, appropriate measures will have to be taken. These could include, for example, passing information to customers or adjusting the distribution strategy.

BaFin's role

BaFin is actively involved in shaping ESMA's work centred on the European legislative process and the establishment of a uniform European administrative practice. For example, it conducts a large number of bilateral and multilateral discussions with association representatives and consumer protection bodies and gives public presentations on the product governance concept in MiFID II. In its supervision, BaFin will be closely involved in the organisational implementation of the product governance rules in the investment firm and – with a sense of proportion – ensure that the key objective of these amendments are realised, i. e. that conflicts with clients' interests are avoided at the earliest opportunity. Desired side effects include that the risks to companies are reduced and the European and German financial markets and their participants are strengthened.

Conclusion

The new product governance requirements, especially the rules on the target market and the newly required close cooperation between manufacturers and distributors, complement the existing conduct of business rules and will thus strengthen collective consumer protection. In addition, the product governance requirements will complement BaFin's product intervention powers, which apply already because they have been anticipated by the Retail Investor Protection Act: if – as an internal control measure – manufacturers and distributors identify the target market accurately and correctly, this can help ensure that financial instruments are only marketed to the appropriate target groups.

1.1.2 Information requirements and cost transparency

Communication on an equal footing between investment firms and clients is what investor protection aims to achieve by applying conduct of business rules – without depriving consumers of their right to be consulted. Both national and European regulation continues to be based on the concept of well-informed consumers who act under their own responsibility. In addition, other aspects, such as behavioural factors, are increasingly gaining importance. This is the reason why the information requirements to which the companies are subject under MiFID II have been expanded, in some cases significantly so. One focus of the new requirements is on the transparency of the costs associated with an investment service.

The current Securities Trading Act[3] already requires detailed cost disclosure in accordance with MiFID I. However, this applies to the overall price the customer has to pay, rather than

3 Section 31 (3) sentence 3 no. 4 of the Securities Trading Act in conjunction with section 5 (2) no. 5 of the German Regulation Specifying Rules of Conduct and Organisational Requirements for Investment Services Enterprises (*Wertpapierdienstleistungs-Verhaltens- und Organisationsverordnung*).

recurring and non-recurring costs, which have so far not been a particular focus. This is set to change. Another point is that many providers have in the past spread information on prices and fees across a large number of documents (for example the list of prices and services, the key information document or the client advice agreement) and only linked them with cross-references, which has made them all the more difficult to understand.

Disclosure of total amount

Pursuant to Article 24(4c) of MiFID II, all costs and charges of the product and investment service will in future have to be aggregated into a total amount – a requirement welcomed by consumer protection bodies. This total amount will be disclosed both before the respective service is provided (*ex ante*) and – where necessary – subsequently (*ex post*). *Ex ante* disclosures that cannot be accurately determined may be estimated as accurately as possible or based on calculation models. *Ex post* disclosures must refer to the costs actually incurred. To allow clients to keep an eye on the overall result, the effect that the costs will have on the return will also have to be explained, in addition to the *ex ante* and *ex post* disclosures.

Presentation more complex

Overall, the presentation of costs, with detailed information on intricate cost structures even within products and services, scenarios and diagrams, will become more transparent, but also more complex as a result. This manifests itself especially when analysing how this interacts with the way costs are presented in accordance with the PRIIPs Regulation, the Regulation on key information documents for packaged retail and insurance-based investment products.[4] Together with other supervisory authorities, including the European Securities and Markets Authority, BaFin is working to ensure that the disclosures under the two sets of rules remain workable and comprehensible, although this is hardly likely to result in complete convergence. The main reason is that some aspects are not covered by the PRIIPs Regulation, but the provisions of MiFID II require them to be part of the cost transparency arrangements. One such example is the cost of service provision.

1.2 Market investigations

In collective consumer protection, BaFin focused on a number of supervisory issues in 2016 by, among other things, conducting comprehensive market investigations into these aspects. BaFin is prompted to carry out individual investigations, for example, by complaints, ongoing supervision, as well as findings made by the European Supervisory Authorities and the supervisory authorities of other EU member states. In such cases, BaFin subjects the supervised companies to a general survey, followed by a systematic analysis of the responses received. BaFin follows up any aspects deserving of further attention at individual institutions, for example during on-site supervision. If the analysis flags up serious or systemic undesirable developments, BaFin will also take supervisory measures against single or multiple entities. BaFin may also formulate best, good and bad practices and circulate this information among the supervised companies.

1.2.1 Transparency deficits in closet indexing

One of BaFin's market investigations in 2016 dealt with the issue of closet indexing (see info box on page 35). To this end, it examined German equities funds with a volume of € 10 million or higher and an equities ratio of at

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

least 51 %. ESMA had previously conducted an investigation with a similar remit.

BaFin's investigation comprised a quantitative part, which was purely based on key indicators, and a qualitative review. During the quantitative analysis, BaFin first identified potential closet indexing funds using only specific key indicators. The aim of the qualitative review was to examine selected potential closet indexing funds to ascertain whether the asset management companies involved are in fact engaged in closet indexing.

Once the qualitative investigation had been completed, the number of funds that gave rise to concerns was reduced to a few individual cases.

However, the management fee charged by these investment funds was significantly lower than that normally levied for actively managed funds. In addition, they are no longer actively marketed.

BaFin demands greater transparency

Given the results of the investigations, BaFin does not see any need at present to intervene in the remuneration structures of the asset management companies. It is, however, demanding greater transparency from the fund industry.

For retail funds with an equities ratio of at least 51 %, asset management companies will in future have to disclose in the prospectus whether they are actively managed or merely track an index. Where companies use a benchmark, they have to name it and explain whether and by how much the fund is expected to under- or outperform the benchmark. In addition, a chart will have to show how the fund and the benchmark used have performed in relation to each other over an extended period.

Asset management companies will in future also have to provide clearer information on the management approach they pursue. This is because they will have to include the additional disclosures in the prospectus, which is a liability document. Up to now, fund prospectuses have not generally provided any specific information on this aspect. The tighter transparency requirements will allow investors to make a better assessment of the activity of fund products.

Closet indexing

Under closet indexing, investment companies claim a fund is actively managed, even though the fund stays very close to a benchmark, meaning that in reality a passive investment strategy is pursued. Criticisms include that investors are given incorrect or even misleading information. In addition, investment companies are accused of charging management fees not commensurate with passive management.

1.2.2 Focus on credit-linked notes

In another market investigation, BaFin has dealt with what have up until now been referred to as credit-linked notes.[5] They are a subform of the certificates investment type, under which investors invest in the creditworthiness of a reference company. Compared with other investment products, the structure of credit-linked notes is very complex: the interest rate and repayment of the cash amount invested are dependent on the credit risks of the reference company. It is normally difficult for retail clients to estimate whether a credit event will occur in relation to the underlying reference liability.

Issuers surveyed

For this reason, BaFin has investigated to what extent and in what form credit-linked notes are issued and what kinds of volumes are also marketed to retail clients in the investment advice business. To this end, BaFin sent out a survey to issuers of credit-linked notes at the beginning of March 2016. Among other

5 www.bafin.de/dok/7873956.

things, the survey covered the volume of the credit-linked notes issued, the average coupon and the origin of the credit risks used in the structuring. BaFin also surveyed approximately 100 companies selected as a sample and asked them about the distribution of credit-linked notes. Among other things, BaFin was interested in the proportion of retail clients who are sold credit-linked notes – whether as a result of investment advice or without such advice. The companies were also asked if the investment advisers used had been specially trained in this area.

Products targeted at retail clients

The feedback revealed that issuers issue credit-linked notes specifically for distribution to retail clients and often recommend them when giving investment advice. It also showed that investment advisers recommend credit-linked notes to investors of all levels of risk appetite, i. e. also to clients with a low risk appetite. From BaFin's perspective, it seems doubtful whether the investment advisers did in each case provide the required level of information on the product features and the risks inherent in the product.

Planned prohibition hearing

The findings from its investigation prompted BaFin in summer 2016 to conduct a hearing on the potential prohibition of the marketing, distribution and sale of credit-linked notes to retail clients.[6] The associations of the affected issuers and distributors responded by publishing a comprehensive voluntary undertaking in order to counter the concerns raised. On this basis, BaFin announced in December 2016 that it would suspend its planned ban and examine the effect of the voluntary undertaking.[7]

1.2.3 Payment protection insurance for consumer loans

In another investigation conducted in the second half of 2016, BaFin took a close look at the issue of payment protection insurance in order to get an idea of the nature and features of this type of insurance. In particular, BaFin wanted to find out to what extent the purchase of payment protection insurance was optional, how contracts were initiated, how much they cost, and how these costs were disclosed.

To this end, BaFin sent extensive sector-specific questionnaires to a total of 66 insurance undertakings and banks. The questions related to product design, as well as contract initiation, implementation and performance. Insurance undertakings were asked in addition to submit sample costings and information on risk and policy acquisition cost results. The analysis of the extensive documentation had not yet been completed at the time of going to press.

1.2.4 Invoking interest rate adjustment clauses

Contractual interest rate adjustment clauses for variable-rate consumer loans were the subject of another market investigation conducted by BaFin. The survey, which was launched at the end of June 2016, is intended to find out whether institutions systematically put customers at a disadvantage by passing on changes in interest rates on consumer loans to customers with an unreasonable delay.

To this end, BaFin wrote to 50 private banks, savings banks and cooperative banks. 13 of the institutions surveyed replied that they did not grant variable-rate consumer loans.

Following in-depth analysis of the other 37 responses, there were indications for a total of 7 institutions that the contract clauses used contravened applicable case law or failed to fully meet the applicable legal requirements. BaFin will continue to pursue this issue.

1.2.5 Dealing with handling charges on policy loans

BaFin conducted an industry-wide survey in 2016 to establish how insurance undertakings deal with handling charges when granting policy loans (see info box on page 37).

6 www.bafin.de/dok/8129812.

7 www.bafin.de/dok/8694186 (only available in German).

Policy loans

Policy loans are loans that life insurance undertakings grant to policyholders on their life insurance policies. The amount of such loans is limited to the surrender value of the corresponding life insurance policy.

In particular, BaFin wanted to establish the volume of handling charges levied by insurance undertakings now and in the past and to what extent the case law of the Federal Court of Justice (*Bundesgerichtshof* – BGH) dating from 2014 has been implemented (see info box "Case law of the Federal Court of Justice").

BaFin included in its investigation all 82 insurance undertakings that reported policy loans in their portfolio as at 31 December 2014.

Positive picture

The analysis of the survey paints a positive picture as these types of handling charges did not play a major role for the vast majority of the 82 insurers. If levied at all, these charges were low, amounting to no more than €50.

More than 70 insurance undertakings have either never levied such handling charges or discontinued the imposition of handling charges long before 2014. Only a small number of insurance undertakings were still levying handling charges at the time the Federal Court of Justice handed down its ruling. These undertakings have also since stopped this practice.

1.3 Hearing on contracts for difference

In December 2016, BaFin initiated another hearing[8], this time on contracts for difference (CFDs). BaFin wants to restrict the marketing, distribution and sale of CFDs in order to protect retail investors. The sale to retail investors

8 See hearing on credit-linked notes, 1.2.2.

Case law of the Federal Court of Justice

In May 2014, the Federal Court of Justice ruled that, under a consumer loan contract pursuant to sections 488 (1), 491 (1) of the German Civil Code (*Bürgerliches Gesetzbuch*), it was irreconcilable with the main intention of the legal provisions to levy a handling charge – agreed under the general terms and conditions – that is not related to the loan term.[9] Pursuant to section 307 (1) sentence 1, (2) no. 1 of the Civil Code, the corresponding clause in the general terms and conditions is therefore invalid and it is thus not permissible to levy a handling charge not related to the loan term in connection with a contract for granting a consumer loan. Based on general understanding, this case law also applies when an insurance undertaking grants a policy loan to a policyholder.

of contracts entailing an obligation to make additional payments should then no longer be permitted.

In contracts for difference entailing an obligation to make additional payments, retail investors are unable to calculate the risk of loss, and BaFin finds that unacceptable. If the difference the retail client has to settle exceeds their invested capital, they have to settle the difference from their other assets (see info box "Speculating with contracts for difference" on page 38).

Losses cannot be limited effectively

In BaFin's opinion, the risk of loss cannot be limited effectively, even if the margin call process is used. This is because price movements of an underlying can be so high within a very short timespan that the CFD issuer does not have the time to make a margin call on the investor to request additional collateral. In such a

9 Judgements of 13 May 2014, case ref. XI ZR 405/12 and XI ZR 170/13.

Speculating with contracts for difference

When entering into contracts for difference (CFDs), investors speculate on changes in the price of underlying instruments, such as indices, shares, commodities, currency pairs or interest rates. The capital invested is lower than in the case of direct investments. Positive or negative changes in the price of an underlying instrument are tracked by the CFD. If the difference is positive, the investor receives the difference; if it is negative, they have to pay the difference.

case, the investor's position would have to be closed out – compulsorily and, in some circumstances, at a loss. Likewise, stop-loss orders do not give investors protection against high losses. The reason is that the next available price at which such an order can normally be executed may vary significantly from the originally targeted price. In some circumstances, the investor will then have to settle a difference that is many times higher than the total amount invested.

The European Securities and Markets Authority had previously warned against CFDs on two occasions, most recently in July 2016. The products caught the public's attention primarily as a result of the Swiss franc shock at the beginning of 2015. At the time, the Swiss National Bank abandoned the minimum exchange rate for the euro, causing many CFD investors to incur heavy losses because they were obliged to make additional payments. Several studies conducted by national supervisory authorities in the EU have confirmed that clients have often lost money with CFD investments.[10] In addition to findings made in the course of ongoing supervision, BaFin had also received a number of customer complaints about CFDs.

10 See, among other publications, press release by the Central Bank of Ireland of 23 November 2015 and press release by the Autorité des Marchés Financiers of 13 October 2014.

Comments on the draft general administrative act could be submitted until 20 January 2017. No decision had been taken on this issue by the time of going to press.

1.4 Consumer complaints and enquiries

1.4.1 Credit institutions and financial services providers

1.4.1.1 Number of complaints

In 2016, BaFin processed a total of 5,162 submissions relating to credit and financial services institutions (previous year: 5,890), of which 4,987 were complaints and 175 general enquiries. The figure includes 26 cases where BaFin issued statements to the Petitions Committee of the *Bundestag* (the lower house of the German parliament). In addition, BaFin received 54 information requests about former banks, and especially their legal successors. The complaints were upheld in 743 cases.

Table 1 Complaints by group of institutions[11]

Group of institutions	Total number of submissions
Private banks	2,664
Savings banks	703
Public sector banks	181
Cooperative banks	657
Mortgage banks	13
Bausparkassen	350
Financial services providers*	129
Foreign banks	290

* For example, leasing and factoring undertakings.

Subject matter of the complaints

In 2016, the submissions again reflected the whole range of products and services

11 The table only contains complaints; no general enquiries are included. For information on prior-year figures, see the 2015 Annual Report, page 58.

provided by the supervised institutions. Most of the complaints related to problems with the processing of loans, payment transactions, and account management. But submissions also related to fees for individual services charged for the first time as well as subsequent increases in these fees. Some consumers also voiced concerns about a number of IT failures at some credit institutions, which affected online banking.

Low interest rate environment

For BaFin, the effects of the persistently low interest rates are relevant not only from the perspective of solvency-related institutional supervision, but also in terms of collective consumer protection. The consequences for consumers manifest in a number of very different ways.

For example, institutions have started to charge negative interest or deposit fees on credit balances in current and savings accounts. While initially this affected only wholesale customers and wealthy retail clients who had considerable amounts of deposits, some institutions are now also charging such interest or fees on smaller deposits. If this trend continues, this could affect a significantly larger number of consumers in future. BaFin will be watching this trend.

Institutions also respond to the low interest rate environment by levying charges. Some consumers complained that their bank was charging fees for managing their current account, which was free of charge before. BaFin examines in such cases whether the institution has followed the proper procedure for these types of amendments to the general terms and conditions. BaFin cannot prescribe to institutions how they design their account models and what fees they charge.

Bausparkassen

Bausparkassen customers, too, are feeling the effects of the persistent phase of low interest rates. The way *Bausparkassen* deal with customers with high-interest legacy contracts varies.

In recent years, there have already been cases where *Bauspar* contracts have been terminated. The consistent opinion of the courts is that the termination of over-saved *Bauspar* contracts is permissible. On 21 February 2017, the Federal Court of Justice ruled in principle that *Bausparkassen* may terminate *Bauspar* contracts that have met the conditions for granting a loan for more than ten years without the savers having taken out the allocated loan.

In addition, some *Bausparkassen* introduced account management fees in some tariffs or proposed to their customers that they switch their contracts to different terms as a way of extricating themselves from *Bauspar* contracts that pay high interest on deposits. Of course, the parties to a *Bauspar* contract entered into years ago are free to terminate it by mutual agreement and to continue the contractual relationship in a different format. It is for the contracting parties to agree the rules for modifying the contract. Consumers have to make up their own minds whether they are willing to accept such a proposal and whether it will be to their advantage. BaFin ensures in this context that consumers receive comprehensible and comprehensive information about the proposed contract amendment to allow them to make an informed decision based on facts and under their own responsibility. For example, BaFin criticised some allocation notifications because they were incomplete: they detailed various options, but failed to inform savers that they could continue to save under the existing *Bauspar* contract.

1.4.1.2 Selected cases

Processing of variable-interest loans

One consumer complained that, after the fixed-interest period had expired, his bank had quoted an incorrect interest rate for continuing his real estate mortgage loan on a variable-interest basis. He claimed the interest rate was too high and had not been determined in accordance with the interest rate adjustment clause agreed in the contract. He maintained that the loan should have been continued at a significantly lower borrowing rate.

When BaFin queried this, the bank conceded that it had determined the wrong interest rate for the customer's loan. It attributed this to faulty encryption in the electronic capture of loan details in the bank's system. It turned out that other agreements this bank had entered into were also affected by the faulty encryption. The institution responded by correcting the fault.

Consumer credit with payment protection insurance

A customer entered into a consumer loan agreement and opted for payment protection insurance at the same time, which was to insure against the risk of incapacity to work, among other things. When the insured event occurred, the insurer refused to cover the loan instalments. The reason for the lack of cover was, however, not attributable to the insurer, but to the way the contract between the bank and the customer had been arranged. In the bank's opinion, the customer had opted for "payment protection life insurance with additional accident insurance and payment protection work incapacity insurance", but according to the documents the box required to be ticked separately to opt into the desired insurance policy had not been ticked.

In response to intervention by BaFin, the institution had to concede that the contractual arrangement was misleading and it was not immediately clear that an additional declaration was needed to get the insurance cover. In response, the bank agreed to assume the payment of the loan instalments not only in this specific case, but promised to do so in all other similar cases. The institution has since revised the wording of the agreement.

Online publication of overdraft interest rates

The German Act Implementing the Mortgage Credit Directive (*Gesetz zur Umsetzung der Wohnimmobilienkreditrichtlinie*)[12] entered into force on 21 March 2016; among other provisions, it introduced rules intended to make the amount of overdraft interest charged more transparent and to afford better protection to consumers using overdraft facilities. One of these rules requires banks and savings banks to publish overdraft interest rates prominently on their websites.[13] In this way, interest rates can be compared quickly and easily. Another intended outcome is to make it more difficult for banks to charge unreasonably high interest on overdrafts.

During spot checks, BaFin found that some institutions had not disclosed the overdraft interest rate online as required by law. Prompted by BaFin's intervention, the institutions concerned ensured immediately that the information was published as required.

1.4.2 Investment and asset management companies

As part of investment supervision, a total of 137 complaints and queries were received from consumers in 2016.

They related to, among other things, the proper liquidation of investment compartments, the calculation of unit performance, the appropriation of income, compliance with publication requirements, fund management costs, the requirement on asset management companies to provide information to investors and possible errors in giving investment advice.

BaFin followed up on the information in each individual case, where necessary asked the complainants for further explanations, and requested any pertinent comments from the supervised companies. There was, however, rarely any need to take further supervisory measures.

Closed-ended funds

Although most of the submissions on closed-ended funds related to legacy funds managed by asset management companies supervised by BaFin or companies affiliated with them, these funds are not subject to

12 See 1.7.

13 Article 247a section 2 (2) of the German Introductory Act to the Civil Code (*Einführungsgesetz zum BGB*).

the provisions of the German Investment Code (*Kapitalanlagegesetzbuch*). In these cases, BaFin informed the complainants and petitioners of this fact and referred to the option to commence civil proceedings or to seek out-of-court dispute resolution.

Open-ended real estate funds

The queries on open-ended real estate funds primarily concerned the liquidation of open-ended real estate funds for retail investors. For example, investors wanted information about the duration of the liquidation phase, adjustments to the market values of fund properties, or when to expect the repayment of the funds invested from an open-ended real estate funds for retail investors in liquidation. BaFin asked the asset management companies or depositaries for comment.

1.4.3 Insurance undertakings

1.4.3.1 Complaint figures

In 2016, BaFin completed the handling of 7,985 submissions relating to the insurance sector. However, since this figure for the first time includes only those submissions for which BaFin is the competent authority, it is not possible to compare it to the prior-year figure (9,746). A comparison of the data for the respective classes of insurance provided in Table 2 shows that 7,830 submissions (previous year: 8,188) were attributable to all insurance classes put together. They break down into 7,361 complaints, 370 general enquiries and 99 petitions, which reached BaFin via the German Bundestag or the Federal Ministry of Finance (*Bundesfinanzministerium* – BMF). 29.8 % (previous year: 26.6 %) of these submissions ended in success for the parties that made them.

The reasons for complaints vary (see Table 3 "Most frequent reasons for complaints in 2016").

Table 3 Most frequent reasons for complaints in 2016

Reason	Number
Type of claims handling/delays	1,266
Issues of coverage	1,176
Sum insured	972

1.4.3.2 Selected cases

Cost of transferring *Riester* contract

One complainant had a pension insurance policy with *Riester* subsidy and wanted to transfer the accumulated pension assets to a *Riester* pension insurance policy at another insurer. However, for the transfer, the new insurer charged costs of 4.5 % of the amount transferred. The complainant argued that the costs should not have been charged, because they had not been contractually agreed.

Table 2 Submissions received by insurance class since 2012

Year	Life	Motor	Health	Accident	Liability	Legal expenses	Building/ contents	Other classes	Miscellaneous	Total
2016	1,817	1,533	1,335	294	460	924	708	759	155	7,985
2015	2,113	1,778	1,267	294	505	722	470	769	1,558	9,476
2014	2,802	1,822	1,545	379	622	675	890	780	1,624	11,139
2013	2,874	1,604	1,927	331	550	635	822	570	1,555	10,868
2012	2,794	1,312	2,360	383	601	683	766	442	1,612	10,953

* Until 2015: misdirected correspondence, intermediaries, etc.; since 2016: intermediaries.

BaFin's examination found that neither the insurance policy nor the insurance terms and conditions or any other contract documents provided any legal basis for charging transfer costs when switching providers. There is no legal obligation either in, say, the German Pension Contracts Certification Act (*Altersvorsorgezertifizierungsgesetz*).

On this basis, the insurer conceded that there was in fact no provision in the contract that allowed transfer costs to be charged. The undertaking reversed the transfer costs plus interest and credited the policy account value. It has now adopted a similar approach to similar cases and is also using a different version of its quotation software. This will allow it in future to agree costs for transferring pension insurance policies in the contract documents, but only up to the legal maximum of €150.[14]

Continued entitlement to benefits under emergency tariff

A complainant whose contract had been assigned to the emergency tariff because of late payments and who had moved his habitual place of residence to another EU country (Spain) filed a claim for the reimbursement of expenses incurred with his private health insurer. However, the insurer refused to cover the costs, arguing that the complainant had moved his habitual place of residence to another EU country. The complainant did not agree with this decision, and for good reason, as it turned out.

If an insured person moves their habitual place of residence to another member state of the European Union or another signatory to the Agreement on the European Economic Area (EEA), the insurance contract remains in force, with the proviso that the insurer will only remain obliged to pay up to the level of benefits that it would have had to pay if the person had remained in the original country of residence. This is specified in section 207 (3) of the German Insurance Contract Act (*Versicherungsvertragsgesetz*). For the emergency tariff, this is additionally specified in section 1 (6) of the 2013 general insurance policy conditions. Under the emergency tariff, there is a statutory minimum insurance cover for emergency treatments (section 153 (1) of the German Insurance Supervision Act (*Versicherungsaufsichtsgesetz*)). Assuming emergency treatment was required for the complainant, the insurer would therefore have had to reimburse the policyholder at the benefit level applicable in Germany.

After a hearing with the insurer, the undertaking acknowledged that its previous policy of rejecting claims after the habitual place of residence had been moved to another EU country was wrong. In the complaint under review, the insurer therefore agreed to settle and in addition revised its internal guidance on processing benefit claims in the emergency tariff.

Unilateral contract modifications

Following the introduction of a new contract portfolio system, an insurance undertaking made the residential building insurance policy of a complainant subject to new insurance terms and conditions. They contained, among other things, a premium adjustment clause, which allowed the insurer to take future loss and cost trends into account when calculating the insurance premium. The terms and conditions of the contract the complainant entered into in 1995 did not include such a clause. Although the insurer undertook in its letter that such a premium adjustment would only be permitted after one year at the earliest, it was a unilateral contract modification made without the policyholder's consent. Unilateral contract modifications are, however, only permissible and binding if they are exclusively legally beneficial for the other contracting party.

BaFin asked the insurer for comment and queried whether other policies were affected by this switch. It turned out that another 21,251 residential building insurance policies had been made subject to the same new contract terms and conditions, which were detrimental to the customers.

14 Section 1 (11) sentence 3 of the Pension Contracts Certification Act.

Moreover, the insurer disclosed that, in the case of 5,685 policies, the flag preventing premium adjustments due to losses in the first year after the switch had not been set correctly, so that premiums were nevertheless adjusted in these cases. In the meantime, the insurer has written to the affected customers and ordered repayment.

When prompted by BaFin, the insurance undertaking ultimately gave an assurance that, in the case of all the affected policies, it would not invoke this clause even after the end of the first year following the switch.

1.4.4 Securities transactions

In 2016, the total number of submissions received from investors in relation to securities transactions was down on the previous year. The number of complaints filed directly with BaFin amounted to 493 (previous year: 581); in addition, there were 188 written enquiries from investors (previous year: 281).

However, in 2016, BaFin again received a large number of complaints from customers of companies domiciled in Cyprus offering cross-border services. The complainants had been persuaded by the Cypriot companies through electronic media to enter into binary option contracts or contracts for difference, with a minimum investment of as little as €250. In subsequent telephone calls, individuals whose actions are to be attributed to the companies in question, offered interested investors a so-called bonus payment in the amount of the contribution the customer had already made. In this process, they failed to inform the customers that they would only have a right to repayment of any remaining balance once they had "traded" forty times the amount invested and the bonus amount. Effectively, this meant that any repayment claim by the customer was invariably excluded. In addition, it was not made clear to customers that trading losses would consume the amount paid in, but not the bonus. What is more, the providers persuaded inexperienced customers, for whom the products in question were not suitable, to enter into contracts by promising them high returns, which they were supposed to generate by following the trading recommendations made by the company.

In the case of companies that purely conduct cross-border services, it is in principle the national competent authority which monitors whether the companies comply with the rules of conduct in their dealings with customers. Accordingly, BaFin informed the respective customers of their right to file a complaint with the Cyprus Securities and Exchange Commission (CySEC). If the customers consented, BaFin for its part also informed CySEC about the nature of the complaint. On this basis, CySEC wrote to the Cypriot securities trading firms on 30 November 2016, informing them about its administrative practice with regard to these types of transactions.

1.4.5 Consumer helpline

Citizens can call BaFin's consumer helpline at +49 (0) 228 299 70 299. In the past year, the advisers dealt with 20,088 (previous year: 22,586) queries about the financial market, specific issues relevant to consumer protection and problems with banks, insurance undertakings or financial services providers. Of these queries, 35 % related to the insurance sector and 46 % to the banking sector. 10 % of calls concerned securities supervision and 9 % related to other issues relevant to consumer protection.

The queries submitted by consumers varied widely. A large proportion of the queries on banking supervision related to the decisions of the Federal Court of Justice on early repayment penalties when real estate loans are repaid prematurely[15] and on handling charges, which are not permitted for *Bauspar* loans.[16] Many callers also wanted to know what the statutory prerequisites were for being entitled to a basic payment account and for what reasons an application could be rejected. Other areas of concern were account management fees and

15 Judgement of 19 January 2016, case ref. XI ZR 388/14.

16 Judgement of 8 November 2016, case ref. XI ZR 552/15.

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 phase of low interest rates.

At the beginning of July 2016, BaFin added the co-browsing feature to the consumer helpline service. It allows consumer helpline advisers to navigate to websites together with callers. This is a convenient way in which callers can be guided through the structure of websites or databases.

1.5 Supervision of advice and distribution in the securities business

1.5.1 Employee and Complaints Register

The Employee and Complaints Register (see info box) is an effective tool of collective consumer protection. It allows BaFin 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 clients. This is because the complaints of which the companies have to notify BaFin are an indicator of potential deficiencies (see Table 4 "Number of complaints notified").

BaFin therefore analyses them on an ongoing basis to identify any accumulations and investigates the associated advice and complaint records. The supervision focuses on establishing whether the buy, sell or hold recommendations made are suitable.

Table 4 Number of complaints notified[17]

Complaints	2015	2016
Private banks	1,546	1,633
Savings banks/*Landesbanks*	1,691	1,837
Cooperative banks	1,299	1,463
Financial services institutions	104	63
Total	**4,640**	**4,996**

The employee notifications (see Table 5 "Number of employees" on page 45) and their identification numbers give BaFin an idea of staff turnover in investment advice and distribution. Companies may only notify BaFin of investment advisers and sales officers, if they have positively established and documented their reliability and expertise for the activity in question. The employees may only be assigned to the activity once their details have been reported.

If the notifications submitted to the register give rise to doubts about the expertise or

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Employee and Complaints Register

Undertakings which provide investment services are required under section 34d of the Securities Trading Act to report their investment advisers and their sales officers, as well as their compliance officers, for inclusion in the Employee and Complaints Register maintained by BaFin. What is noteworthy for investment advisers is that BaFin also receives reports whenever retail clients make a complaint relating to their investment advice activities.

17 The total number of complaints has been adjusted for the number of corrections reported. Complaints notified by investment services enterprises that were no longer supervised in accordance with part 6 of the Securities Trading Act (sections 31 *et seq.*) at the time of the database query are not included. Moreover, institutions can move from one group of institutions to another. Another factor is that – unlike the practice in earlier annual reports – the figures for both 2015 and 2016 were produced on the basis of the respective quarterly totals. The totals for different reference periods (quarters, years or period as a whole) may vary therefore, depending on the date of the query. The figures presented here may therefore differ from data previously published or published elsewhere. Furthermore, future comparisons will have to take into account those complaints that have been deleted in the course of the storage period in accordance with the applicable requirements.

reliability of an employee or employees draw attention to themselves as a result of violations of supervisory requirements, BaFin will initiate investigations and put the accusation to the company and the employee concerned. In most of these cases, the companies will take remedial action of their own accord, for example by retraining the employees in question, removing them from the reportable activity, or terminating their employment. Otherwise, BaFin may prohibit them from deploying the employee for a period of up to two years. In cases where such employees started work at other investment services enterprises without their new employer being aware of the violations, BaFin took action in the course of the year.[18]

The Employee and Complaints Register is complemented by on-site supervision. In the course of the year under review, BaFin visited 153 head offices and branches, where it spoke to 810 employees, of whom 229 worked in investment advice and 207 in sales management.

1.5.2 Supervisory priority area: sales policies and objectives

The sale of financial instruments and the protection of customer interests have conflicting priorities. Investment services enterprises are required to set, implement and monitor sales policies and objectives in such a way that customer interests are not compromised.

They also have to document these sales control measures.

Table 5 Number of employees[19]

Employees

as at	31 Dec. 2015	31 Dec. 2016
Private banks	45,764	43,148
Savings banks/ *Landesbanks*	61,832	58,500
Cooperative banks	43,378	41,206
Financial services institutions	5,552	6,302
Total	**156,526**	**149,156**

Investment advisers

as at	31 Dec. 2015	31 Dec. 2016
Private banks	44,789	42,576
Savings banks/ *Landesbanks*	58,854	55,545
Cooperative banks	40,361	38,333
Financial services institutions	5,036	5,754
Total	**149,040**	**142,208**

Sales officers

as at	31 Dec. 2015	31 Dec. 2016
Private banks	8,122	7,017
Savings banks/ *Landesbanks*	9,820	9,536
Cooperative banks	7,116	6,800
Financial services institutions	378	370
Total	**25,436**	**23,723**

Compliance officers

as at	31 Dec. 2015	31 Dec. 2016
Private banks	110	101
Savings banks/ *Landesbanks*	413	406
Cooperative banks	978	926
Financial services institutions	696	670
Total	**2,197**	**2,103**

18 See chapter II 1.5.3.

19 Since employees may perform multiple activities, the total based on the activities performed exceeds the total number of employees. The dataset changes all the time as amendments and corrections are notified. Employees notified by investment services enterprises that were no longer supervised in accordance with part 6 of the Securities Trading Act (sections 31 *et seq.*) at the time of the database query are not included. The figures presented here may therefore differ from data published previously.

At the end of 2013, BaFin published on its website information about whether sales policies and objectives exist and how sales officers should be categorised.[20] The concept of sales policies and objectives is also applied, for example, where there is only an indirect link to the recommendations made by investment advisers. This means that soft guidance issued to employees of institutions suggesting that they should address certain classes of financial instruments falls under the term of "sales policies and objectives" in the same way as hard weekly targets for teams of advisers that the company derives from its overall planning.

BaFin regularly examines the sales structures in the branches.[21] The discussions on site are conducted routinely or in response to specific events – for example following information provided by whistleblowers. In order to get an additional overview of the sales practices, BaFin took a look at institutions it had selected according to risk criteria in 2016, focusing on, among other things, the question of whether they had sales policies and objectives in place that exceeded the remit of organisational and work instructions. This was motivated by the fact that when team leaders apply undue pressure in order to reach or exceed sales targets faster, there is a risk that customer interests will be compromised. It is therefore important that the institutions have effective control systems in place with which, firstly, the sales function itself and, secondly, the compliance function under the Securities Trading Act monitor sales control compliance (first and second lines of defence).

For selected inspections, BaFin not only initiated an analysis of the documentation status and of discussions with employees on the issue of sales policies and objectives, but also ordered a check of the internal communication. For selected periods, the auditors it had engaged examined the entire e-mail correspondence of those sales officers who work at key interfaces in the sales hierarchy. Because of the extremely large volume, they used keyword analysis in the examination of the e-mail texts and file attachments and looked into similarity patterns, some of which they also identified with the help of software.

The audit revealed that the organisation in the audited companies was generally suited to preventing customer interests from being compromised as a result of sales policies and objectives. In isolated cases, sales officers needed additional training or control systems had to be standardised. In one case, BaFin examined the configuration of sales policies and objectives of the institutions, which went beyond their internal sales control.

1.5.3 Measures and administrative fine proceedings

Measures

At the end of 2016, BaFin investigated in 23 ongoing proceedings the insights it had gained into unreliable investment advisers and sales officers. In one case, an employee's expertise had been called into question. In another, BaFin issued a warning after an investment adviser had repeatedly violated the conduct of business rules, which have to be observed when giving investment advice. The company's internal controls had independently flagged up the case as well. In a second case, the warning procedure had not been completed at the end of 2016. In this case, BaFin investigated repeated complaints in the Employee and Complaints Register, found repeated violations and identified the employee concerned, who had changed companies.

Administrative fine proceedings launched by BaFin

BaFin launched seven administrative fine proceedings in 2016, primarily because of violations of the conduct of business rules as well as organisational and transparency requirements; it concluded eight proceedings by imposing an administrative fine. A total of 10 proceedings were discontinued, 6 of them for discretionary reasons. A total of

20 www.bafin.de/dok/7846708 (only available in German).

21 www.bafin.de/dok/7868918 (only available in German).

65 proceedings were still pending from the previous year.

Administrative fine proceedings before the Local Court in Frankfurt am Main

In a trial before the Local Court (*Amtsgericht*) of Frankfurt am Main, a case was heard relating to four intentional violations of the investment advice documentation requirements.[22] The credit institution concerned had issued an internal organisational instruction to the effect that customers who received advice at a meeting they attended in person should, at their request, be allowed to enter into a transaction immediately without previously having had sight of the investment advice minutes. Counter to the view taken by the credit institution, it was, however, not permissible to extend the exceptional rules that apply to investment advice given by telephone to face-to-face advice. These exceptional rules are reserved for cases where the investment advice is provided and the transaction is concluded using means of communication that do not permit the minutes to be presented in the intervening time before the transaction is concluded. The Local Court of Frankfurt am Main imposed administrative fines totalling €32,000.

1.6 Dispute resolution

Consumer Dispute Resolution Act and Regulation on Financial Dispute Resolution Entities

The German Consumer Dispute Resolution Act (*Verbraucherstreitbeilegungsgesetz*)[23], which implements the European provisions of the Alternative Dispute Resolution Directive and sets new standards for independent, transparent arbitration proceedings, entered into force on 1 April 2016. The arbitration board at BaFin is now an official consumer dispute resolution entity, and a large number of long-established private dispute resolution entities have been recognised as consumer dispute resolution entities by the Federal Office of Justice (*Bundesamt für Justiz*). By the same token, the responsibilities of the arbitration board at BaFin have been expanded through section 14 of the German Injunctions Act (*Unterlassungsklagengesetz*). The dispute resolution procedure is governed by the German Regulation on Financial Dispute Resolution Entities (*Finanzschlichtungsstellenverordnung*), which entered into force for the arbitration board at BaFin on 1 February 2017.[24]

Cooperation with other dispute resolution entities

The arbitration board at BaFin has been a member of the financial dispute resolution network (FIN-NET)[25] at the European Commission since 2012, which helps customers resolve cross-border disputes out of court. In September 2016, the arbitration board at BaFin, together with the other national members of FIN-NET and with the support of the Federal Ministry of Finance, hosted a plenary meeting in Berlin, the first such meeting to be held in Germany.

On 8 September 2016, BaFin hosted a meeting of representatives of the financial sector's dispute resolution entities for the fifth time.

1.7 Mortgage Credit Directive

The European Mortgage Credit Directive (MCD) of 4 February 2014[26] was transposed into German law with the Act Implementing the MCD (*Gesetz zur Umsetzung der MCD*) as at 21 March 2016.[27] To ensure the protection of consumers raising real estate loans, a large number of requirements have been set out in different laws, in particular in the German Civil Code (*Bürgerliches Gesetzbuch*) and the German Introductory Act to the Civil Code (*Einführungsgesetz zum BGB*).

22 For information on sanctions imposed by the Securities Supervision Directorate, see also 3.2.1 and chapter V 7.

23 See 2015 Annual Report, page 65.

24 See 2016 activity report of the Arbitration Board of the Federal Financial Supervisory Authority, www.bafin.de/dok/8852140 (only available in German).

25 The website of the financial dispute resolution network can be found at: http://ec.europa.eu/finance/fin-net.

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

27 Federal Law Gazette No. 12, page 396.

Other changes can also be found in the German Industrial Code (*Gewerbeordnung*), the German Payment Services Supervision Act (*Zahlungsdiensteaufsichtsgesetz*), the German Insurance Supervision Act (*Versicherungsaufsichtsgesetz*) and the German Banking Act (*Kreditwesengesetz*).

A new section, 18a, has been added to the German Banking Act, which specifies a large number of obligations that banks have to meet when granting consumer real estate loans. They include in particular requirements in terms of (pre-)contractual information obligations, the assessment of creditworthiness, the independence of appraisers from the lending process and adequate qualification of bank employees who work in lending. BaFin has set out the requirements for the qualifications and expertise of internal and external employees in a dedicated regulation.[28]

The new provisions of the MCD Directive led to uncertainty at the credit institutions, especially in relation to the creditworthiness assessment. For this reason, legislators are planning to specify the requirements in greater detail. The Federal Ministry of Finance and the Federal Ministry of Justice and Consumer Protection (*Bundesministerium der Justiz und für Verbraucherschutz*) are to use the regulatory route to set out guidelines for assessing creditworthiness. This is to ensure that young families and older people are not disadvantaged in the residential mortgage lending process.

1.8 Transposition of the Deposit Guarantee Schemes Directive

The German Deposit Guarantee Act (*Einlagensicherungsgesetz*) entered into force in July 2015. This act transposes the harmonised provisions of the European Deposit Guarantee Schemes Directive into German law with the intention of strengthening investor protection.[29]

The deposit guarantee schemes will in future have to perform stress tests at least every three years, starting in 2017. These tests examine and ensure the resilience and viability of the institutions. In addition, because of the stricter requirements imposed by the act, the German deposit guarantee schemes will have to have set aside funds equivalent to at least 0.8 % of the covered deposits by 2024. The German Compensation Scheme Funding Regulation (*Entschädigungseinrichtungs-Finanzierungsverordnung*) sets out the requirements for financing statutory compensation schemes in more detail. The regulation entered into force on 5 January 2016. Institutions assigned to the statutory compensation schemes paid their first annual contributions in 2016 in accordance with this regulation.

Under the Deposit Guarantee Act, depositor compensation must now be paid within seven working days. Bank customers no longer have to make an application. The protection schemes now also have to meet increased reporting requirements to BaFin. Their member institutions have to provide more comprehensive information to depositors about how they are protected. These obligations also apply to the institutional protection schemes recognised as deposit guarantee schemes of the German Savings Banks Association (*Deutscher Sparkassen- und Giroverband*) and the National Association of German Cooperative Banks (*Bundesverband der Deutschen Volksbanken und Raiffeisenbanken*), which have also begun to set funds aside towards their target capital base.

The implementation of the Deposit Guarantee Schemes Directive has also made further progress at the European level. As early as 2015, the European Banking Authority (EBA) developed guidelines on the member institutions' payment commitments to deposit guarantee schemes and on how contributions are levied. In February 2016, it published guidelines on cooperation agreements with the deposit guarantee schemes of other European countries. In addition, in October 2016, it released guidelines on stress tests of deposit

28 German Regulation on Real Estate Lending Expertise (*Immobiliar-Darlehensvergabe-Sachkunde-Verordnung*) of 25 April 2016, Federal Law Gazette I page 926.

29 See 2015 Annual Report, page 51 ff.

guarantee schemes. BaFin was involved in the above processes as a member of the competent working groups.

1.9 Basic payment account

Since 19 June 2016, every consumer in Germany has had the right to a payment account with basic functions (basic payment account), irrespective of their credit status. This is set out in the new German Payment Accounts Act (*Zahlungskontengesetz*), which transposes the European Payment Accounts Directive into German law. Under the Payment Accounts Act, every consumer who legally resides in the European Union (EU) has a right to the basic payment account. This also includes persons with no fixed address, asylum seekers and persons whose deportation is subject to temporary suspension, i. e. who do not have a residence permit, but cannot be deported for legal or factual reasons. The aim of the basic payment account is to give all consumers the opportunity to participate fully in economic and social life.[30]

Obligation on banks

The act obliges all institutions offering payment accounts for consumers to enter into basic payment account contracts (obligation to contract). Banks must offer a basic payment account to all eligible parties who apply for one within ten business days. Institutions must provide the consumer with an application form free of charge. This form, which is prescribed by law, can also be accessed on the institutions' and on BaFin's websites.[31]

Only under certain conditions may banks terminate a consumer's basic payment account or refuse to open one to begin with. For example, they can refuse to open an account if the consumer already has a usable basic payment account with another credit institution in Germany. The bank can also refuse an application for such an account if the consumer has been convicted of a criminal offence against the bank, one of its employees or one of its customers in the three years prior to making the application. Grounds for rejection also include instances where the institution terminated a consumer's basic payment account because the consumer intentionally used it for illegal purposes. The same applies if provisions aimed at preventing money laundering and terrorist financing demand that an institution refuse to open the account.

In addition to the rules for the basic payment account, the Payment Accounts Act contains provisions intended to ensure greater transparency of the fees charged by banks as well as for greater competition, especially by making it easier to switch accounts. Since 18 September 2016, payment service providers have had to support consumers who wish to switch accounts.

1.10 International developments

1.10.1 Information documents

Under the European PRIIPs Regulation, manufacturers of packaged retail and insurance-based investment products (PRIIPs) have to publish key information documents (KIDs; see info box on page 50). Anyone who sells, or gives advice on, such products will have to provide retail investors with these information documents (PRIIPs KIDs) before committing themselves to a binding contract or offer. The Regulation specifies the form and content of the key information documents.

Regulatory standards on PRIIPs KIDs

At the beginning of April 2016, the Joint Committee of the three European Supervisory Authorities (ESAs), presented draft regulatory technical standards on the key information document for PRIIPs to the European Commission for approval. The European Commission initially approved the draft. However, since the European Parliament (EP) rejected the proposal, the Commission withdrew its approval and submitted to the ESAs proposed amendments on the basis of the criticisms raised by the EP. The ESAs were given six weeks to comment. The amended

30 See 2015 Annual Report, page 119.

31 www.bafin.de/dok/7906372 (only available in German).

PRIIPs and KIDs

PRIIPs: packaged retail and insurance-based investment products subject to investment risk. Packaged products within the meaning of the PRIIPs Regulation are all investment products and contracts where the customers' funds are not invested directly, but indirectly on the capital market, or the amount repayable is otherwise exposed to the performance of certain securities or reference values.

KIDs: key information documents. Pre-contractual key information documents for retail investors to allow them to understand and compare the fundamental features and risks of PRIIPs.

regulatory standards are now expected to be approved and enter into force in mid-2017. The original target date had been 31 December 2016. The application of the PRIIPs Regulation, which entered into force in December 2014, has been postponed to 1 January 2018 in an accelerated legislative process. In 2017, the ESAs are additionally planning to issue interpretive guidance for the above-mentioned regulatory standards. BaFin was actively involved in all the ESAs' legislative acts referred to here.

Other information documents at European level

In addition to the PRIIPs key information document, other information documents are being developed at the European level.

The Payment Accounts Directive (PAD)[32] requires the EBA to develop regulatory technical standards in order to define consistent terminology for the Union on the most representative national payment services as well as to develop implementing technical standards on the "fee information" and "statement of fees" documents.

The format and contents of these information documents will be governed by implementing technical standards, which provide specific instructions on how to prepare information documents and contain sample information documents.

The fee information document provides *ex ante* information on fees that will be charged for services in connection with the payment account. By contrast, the statement of fees lists all fees actually incurred individually for services in connection with the payment account in the specified period.

The deadline set in the Payment Accounts Directive for the preparation of the regulatory and implementing standards by 18 September 2016 was not met by the EBA. The consultation process for the EBA's proposed technical standards continued for several months at the end of 2016. Final versions of the technical standards are therefore expected in the first quarter of 2017 at the earliest.

In addition, Article 20 of the Insurance Distribution Directive (IDD)[33] specifies a standardised European product information document for property/casualty and private health insurance (insurance product information document – IPID). The European Insurance and Occupational Pensions Authority (EIOPA) approved an implementing technical standard (ITS) on the IPID and submitted it to the European Commission on 7 February 2017. It sets out rules on the layout, headings, sequence and graphics of the IPID. The requirements for the content of the product information document are specified in the IDD. They largely correspond to the existing German provisions of the Regulation on Information Obligations for Insurance Contracts (*Verordnung über Informationspflichten bei Versicherungsverträgen*).[34]

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

33 Directive 2016/97/EU, OJ EU L 26/19.

34 Regulation on Information Obligations for Insurance Contracts of 18 Dec. 2007, Federal Law Gazette 2007 Part I No. 66, page 3004.

1.10.2 FinCoNet

In February 2016, BaFin joined the Financial Consumer Protection Network (FinCoNet). Established in 2013, FinCoNet is a registered association under French law. Its purpose is to promote the exchange of information on consumer protection issues in the financial sector at an international level among supervisory authorities and other government institutions. Within FinCoNet, members have the opportunity to help develop and enhance consumer protection standards and practices across the world.

Since November 2016, BaFin has also been represented on FinCoNet's Governing Council, where it can exert critical influence on how FinCoNet is managed and what it deals with. At present, FinCoNet is addressing, among other issues, online lending platforms for short-term, high-interest loans as well as supervisory practices and tools to be used to reduce risks for consumers in the digital age.

2 Market integrity

2.1 Authorisation requirements

In the year under review, BaFin received 1,022 new requests to examine whether an authorisation was required (previous year: 918). It concluded 1,150 such requests in 2016 (previous year: 1,092; see info box "Authorisation requirements").

2.2 Exemption from the authorisation requirement

Pursuant to section 2 (4) of the Banking Act, BaFin can, on the grounds of certain atypical banking activities, exempt individual companies from the authorisation requirement and from individual provisions of ongoing supervision under the Banking Act. A prerequisite is for exemption is that, in the authority's opinion, the operator does not require supervision. Exemption can be considered, for example, if the banking business activity is carried out in association with a principal activity that is not subject to authorisation and therefore only represents a comparatively low-level auxiliary or ancillary activity.

Authorisation requirements

As part of its responsibilities, BaFin examines whether investment and retirement savings offerings require authorisation under the Banking Act (*Kreditwesengesetz*), Insurance Supervision Act (*Versicherungsaufsichtsgesetz*), Payment Services Supervision Act (*Zahlungsdiensteaufsichtsgesetz*) or the Investment Code (*Kapitalanlagegesetzbuch*). If so, the provider will require authorisation to carry on its business.

If necessary, BaFin can enforce supervisory measures to ensure that the companies comply with the authorisation requirement.[35]

Guidance notices issued by BaFin allow providers of new business models to perform an initial self-assessment before launching an investment offering. Moreover, potential operators can ask BaFin on a voluntary basis to examine whether their business venture requires authorisation. This gives them a higher level of legal certainty.

35 For information on supervisory measures, see 2.3.

BaFin exempted 15 companies from supervision for the first time in the year under review (previous year: 13). This takes the number of institutions exempt from the authorisation requirement under the Banking Act at the end of the year to 355.

Foreign credit institutions that want to provide cross-border services in Germany can, in principle, also be exempted. However, this can only be done if, according to BaFin's assessment, the providers are subject to equivalent supervision in their respective home country. In 2016, BaFin granted exemption to 2 foreign credit institutions (previous year: 9).

2.3 Fight against illegal investment schemes

In the interest of the integrity of Germany as a financial centre, legislators have mandated BaFin to rigorously enforce the authorisation requirement governed by the Banking Act, the Insurance Supervision Act, the Payment Services Supervision Act and the Investment Code for certain types of financial and insurance business (see info box "Illegal investment schemes"). The systematic fight against illegal investment schemes also serves to protect investors and consumers, who are to be prevented from entrusting their money to dubious profiteers, for example.

As a threat-prevention authority, BaFin is tasked with identifying and prohibiting unauthorised business activities at an early stage, ideally before customers suffer any irreversible losses. The law gives BaFin extensive powers of investigation and intervention that compare favourably by international standards. For example, BaFin can demand detailed information and the disclosure of documents on all business matters. If there is concrete evidence of unauthorised business activities, it can order on-site inspections, which are carried out by its employees.

BaFin can search business and private premises and confiscate incriminating evidence. However, searches require a court warrant, unless there is an imminent threat. If the suspected unauthorised business activity is confirmed, BaFin can order its cessation and force the provider to wind up the transactions entered into; it can appoint a liquidator to monitor and implement the liquidation process. In addition, BaFin can issue instructions, impose coercive fines and apply to the competent administrative court for an order of a mandatory prison term.

Under the respective supervisory laws, unauthorised business activities are liable to a prison term of up to five years or a fine. The appropriate criminal prosecution is the responsibility of the prosecuting authorities. BaFin supports the public prosecutors' offices by sharing its expertise, including on site. In 2016, the prosecuting authorities involved officials of BaFin as experts in five major searches at six locations in total.

New investigations

In 2016, BaFin initiated a total of 1,113 new investigations (previous year: 672); it concluded

Illegal investment schemes

The main feature of illegal investment schemes is that providers engage in unauthorised business activities, for which they would normally require authorisation under the Banking Act, the Insurance Supervision Act, the Payment Services Supervision Act or the Investment Code. These companies try to escape the authorisation procedure put in place by the government and in this way harm not only the integrity of the financial centre, but also individual customers. In a worst-case scenario, out-of-control illegal investment schemes can threaten the stability of the entire financial market.

962 proceedings (previous year: 669). As part of its investigations, BaFin issued formal requests for information and the submission of documents to companies or individuals in 34 cases (previous year: 58). It imposed coercive fines in 26 cases (previous year: 23).

In 2016, in its pursuit of unauthorised business activities, BaFin carried out one on-site inspection on the basis of formal orders for inspections. It obtained search warrants from the Local Courts (*Amtsgerichte*) against 17 operators and companies involved; on this basis, BaFin officials, with the support of the Bundesbank and the police, searched 30 properties at 15 locations.

Prohibitions

BaFin issued 18 prohibition orders in 2016 (previous year: 12). It issued liquidation orders on 23 companies (previous year: 32). Objections to formal measures of this kind were raised in 72 cases in the year under review (previous year: 52). BaFin completed 77 objection proceedings in this period (previous year: 44), 49 of them on the basis of formal objection notices (previous year: 27).

Court proceedings

In 2016, the Administrative Court (*Verwaltungsgericht*) of Frankfurt am Main rejected 16 objections to notices issued by BaFin in summary proceedings; in 2 cases, it ordered that the legal remedies should have a suspensory effect. In the main proceedings, BaFin won a total of 13 cases before the Administrative Court of Frankfurt in 2016; in 1 case, the Administrative Court ruled in favour of the plaintiff in the year under review. In 2016, the Higher Administrative Court (*Verwaltungsgerichtshof*) of Hesse concluded 5 cases in interim relief proceedings and 3 appeal proceedings; it ruled in favour of BaFin in all these cases. In another case, it allowed an appeal against the decision of the previous instance; this case is still pending. 2 cases that had been brought before the Federal Administrative Court (*Bundesverwaltungsgericht*) for a decision were ruled in BaFin's favour.

BaFin's interpretation confirmed

In 2016, BaFin prohibited a Hamburg-based pawn shop from issuing loans against bearer land charge certificates and bearer shares and ordered it to unwind the funds raised. In BaFin's opinion, this type of transaction is not covered by the pawnbroker privilege. The official explanation for the Banking Act and the provisions under federal state law on handling pawned items make it sufficiently clear that only movable items are eligible as security in a pawn transaction. The security has to be stored in suitable premises and insured against theft, fire and water damage. Moreover, according to the legal provisions, the pawner is prevented from accessing the pawned item, because it is held by the pawnbroker. By contrast, bearer certificates are rights attached to certificates whose value is derived from another asset. The latter is, however, specifically not in the pawnbroker's possession. Accordingly, bearer certificates cannot be securities in a pawn transaction. This interpretation was also confirmed by the Administrative Court of Frankfurt am Main[36]. The decision carries fundamental significance beyond this specific case in Hamburg: without this ruling, pawnshops could have turned into companies that transact bank-like business on an unregulated basis.

Another landmark decision

The Administrative Court of Frankfurt am Main also confirmed BaFin's interpretation in another landmark decision. Accordingly, a company is subject to the authorisation requirement in accordance with the Banking Act if its business model – when its lending and deposit-taking business is considered as a whole – is similar to the activities of a credit institution. In the case in question, the operator intended to raise capital by issuing profit participation rights with qualified subordination clauses and by issuing its own bearer bonds. In the lending business, the company was planning to lend the funds raised from others to wholesale customers in two different ways – either as loans with a qualified

36 Judgement of 22 June 2016, case ref. 7 K 642/16.F.

subordination clause or in exchange for the issuance of bearer bonds based on models that the operator intended to make available on its website. The Administrative Court confirmed BaFin's opinion that both lending variants met the criteria of the lending business in all cases where the operator refinanced itself by raising repayable funds from the general public. The judgement against the operator has since become final.

2.4 Contact point for whistleblowers

In July 2016, BaFin established a central contact point, which whistleblowers can use to report violations of supervisory provisions (see info box).[37] Whistleblowers are individuals who have specific knowledge of a company's internal affairs – for example, because they are employed there or are in another contractual or trust relationship with the company. Whistleblowers therefore play an important role in identifying violations of supervisory law. They can make a valuable contribution to uncovering misconduct by individuals or entire companies in the financial sector and to stemming and correcting the negative consequences of such misconduct.

Special protection

The legal basis for establishing the contact point for whistleblowers is section 4d of the German Act Establishing the Federal Financial Supervisory Authority (*Finanzdienstleistungsaufsichtsgesetz*), which was introduced by way of the German First Financial Markets Amendment Act (*Erstes Finanzmarktnovellierungsgesetz*).

Under this section, the protection of whistleblowers enjoys the highest priority.[38] BaFin has therefore developed a system to give special protection to the identity of whistleblowers and the individuals affected by the reports. As a rule, BaFin will therefore not reveal the identity of whistleblowers to third parties. Employees of supervised companies who turn to the contact point for whistleblowers are not held liable under labour or criminal law. Irrespective of the above, whistleblowers also have the opportunity to contact BaFin anonymously.

Whistleblowers can submit their reports to BaFin by letter, e-mail or telephone, in person or through an electronic reporting platform.

In 2016, the contact point for whistleblowers received a total of 124 reports. Half of them related to alleged violations by supervised institutions. BaFin investigates these reports, whose quality and significance varies considerably. Approximately one third of the submissions related to potentially unauthorised business activities, which BaFin also investigates.[39] Five reports related to complaints, which were passed to the consumer protection department for further processing. The remaining reports related to matters for which BaFin is not the competent authority, or that did not contain any identifiable facts.

Contact point for whistleblowers

The contact point for whistleblowers is not a substitute for BaFin's consumer helpline[40], but is aimed at individuals who have specific knowledge of a company's internal affairs – for example, because they are employed there or are in another contractual or trust relationship with the company.

37 See BaFinJournal January 2017, page 24 ff. (only available in German); information on the contact point for whistleblowers can be found on BaFin's website at www.bafin.de/dok/8119390.

38 See section 4d (6) of the Act Establishing the Federal Financial Supervisory Authority.

39 For information of authorised business activities, see 2.3.

40 See chapter 1.4.5.

3 Discussion topic: Sanctions

3.1 Opinion

Béatrice Freiwald on sanctions and measures

Béatrice Freiwald

Béatrice Freiwald is Chief Executive Director of Internal Administration and Legal Affairs.

The supervisory measures that BaFin adopts for the purpose of averting threats, and administrative fines that are aimed at warning parties subject to supervision of the need to comply with their statutory obligations, are often lumped together and referred to as sanctions. The reason for this is obvious given that in non-legal usage the term "sanction" is associated with each and every supervisory reaction to misfeasance. It seems there is an impression that BaFin imposes sanctions whenever there is a breach of supervisory law. However, such a sweeping understanding of the term fails to do justice to the complexities of German law.

Specific trade supervision of natural persons and legal entities

In addition to market supervision, BaFin exercises specific trade supervision. Although legislators have transferred many other duties to it over the years, the core question in BaFin's day-to-day supervisory practice remains whether measures[41] need to be implemented to ensure the solvency of banks and insurers or to protect financial market integrity and transparency and/or consumers[42]. And if so, the next question is which measures are necessary and appropriate to achieve this objective in each specific case.

BaFin has an extensive catalogue of measures at its disposal; these are set out in specialised legislation such as the German Insurance Supervision Act (*Versicherungsaufsichtsgesetz*), Banking Act (*Kreditwesengesetz*) and Securities Trading Act (*Wertpapierhandelsgesetz*). These measures enable BaFin to take action against both legal entities (undertakings) and natural persons. For instance, BaFin can impose increased capital requirements on a credit institution if its solvency risks are not adequately covered by its existing equity. It can also issue warnings to managers and demand their dismissal if they do not have adequate professional qualifications or are considered unreliable for supervisory purposes. The same is true for members of supervisory boards and persons with key functions at insurance undertakings (section 24 of the Insurance Supervision Act) and investment advisers (section 34d of the Securities Trading Act).

Intervention in the rights of parties subject to supervision

Each and every intervention in the rights of the undertakings and natural persons subject to supervision requires sufficient legal authorisation. The intervention itself usually takes the form of an administrative act (*Verwaltungsakt*) and generally only occurs after the party concerned has been heard. If, as an exception, the measures are not aimed at individual parties but at a specific

41 For the measures, see 1.5.3, chapter III 2.4.3 and chapter IV 2.4.

42 The Retail Investor Protection Act defines collective consumer protection in law as one of BaFin's duties.

group of parties, BaFin may employ a general administrative act (*Allgemeinverfügung*), as was the case in the recent hearing on restricting trading in financial contracts for difference (CFDs).[43] If BaFin's intention is to regulate a range of issues in a generally binding manner, in certain cases specified in law it can issue regulations.

Measures are usually preventive for the purpose of averting threats

The vast majority of BaFin's actions are preventive in nature and are aimed at averting threats. In order to first identify a threat situation, BaFin can request information, require documents to be submitted and order ad hoc audits in addition to conducting regular supervisory consultations and audits. It is not uncommon for organisational deficiencies to be identified as part of such fact-finding interventions, and BaFin subsequently requests that the affected undertaking take remedial action, initially on a non-formal basis. For the most part, the undertakings follow BaFin's informal requests.

However, there are situations in which BaFin must formally intervene to avert threats. In such cases, BaFin might order the undertaking to take a specific course of action or refrain from doing something, or issue orders that concern the members of the governing bodies (e.g. a caution or dismissal request) or the further operation of the business (e.g. prohibit new business from being transacted, suspend an authorisation or permit, order liquidation). These measures, which sometimes encroach heavily on the rights of undertakings or persons, likewise serve to avert threats to the financial system, creditors, consumers or insured persons.

BaFin can enforce orders by means of enforcement measures

If the persons or undertakings concerned fail to follow BaFin's orders, BaFin can – following a prior warning – determine enforcement measures in accordance with section 17 (1) of the Act Establishing the Federal Financial Supervisory Authority (*Finanzdienstleistungsaufsichtsgesetz*). Coercive fines, which routinely come into consideration, can amount to a maximum of €2.5 million for each instance of non-compliance. Although on first impression coercive fines do appear to bear a resemblance to sanctions in some aspects, they are not classed as punitive administrative actions and serve solely to enforce the duty of a natural person or legal entity to do or refrain from doing something.

Immediate enforcement

The considerable importance of the preventive fact-finding and threat aversion measures employed by BaFin is expressed in particular in section 49 of the Banking Act, section 310 (2) of the Insurance Supervision Act and various provisions of the Securities Trading Act. Here, legislators order that legal remedies against the specified measures and the associated enforcement measures do not have a suspensory effect. In a departure from convention, the enforcement of such measures thus cannot be prevented or suspended solely by filing objections or actions to annul measures. Instead, BaFin can routinely enforce its orders without delay since legislators have recognised their urgency and the fact that they cannot be postponed.

Prevention…

For preventive supervisory actions aimed at averting threats, it is not necessary for an obligation to have been breached. In fact, in the best case scenario, a breach of duty is actually avoided. BaFin does indeed react to violations of supervisory duties – such as reporting obligations – with measures, for example by determining that business processes are poorly organised and consequently ordering a capital add-on to cover the resulting risks until such time as the underlying causes have been remedied. However, such measures serve not to punish specific violations, but rather to avert the resulting threats.

43 See 1.3.

… vs. punishment

A distinction must be made between averting threats and BaFin's power to impose administrative fines for certain violations of duties under supervisory laws.[44] Punishing violations is exclusively a matter for (punitive) law on breaches of administrative regulations and for criminal law, but the responsibility for the latter lies solely with the prosecuting authorities.

No administrative fines without a law

The principle of "no penalty without a law" (*nulla poena sine lege*) is anchored in the German constitution and applies in criminal law and law on breaches of administrative regulations (section 3 of the German Act on Breaches of Administrative Regulations (*Ordnungswidrigkeitengesetz*)). As a consequence, BaFin can only impose administrative fines for such violations of supervisory law as are stipulated in the legislation. European legislation has significantly expanded the catalogue of administrative fine criteria in the recent past, in particular in the Banking Act and Securities Trading Act, and this also applies to the scale of administrative fines.[45] The scale determines the maximum amount of the administrative fines, which must be appropriate in each specific instance. In grossly simplified terms, this means that the amount of an administrative fine should at the minimum exceed the economic benefit derived from the violation.[46] The maximum fine stipulated in section 39 (4a) sentence 2 no. 1 of the Securities Trading Act is €15 million or 15% of the total revenue of a legal entity or association of persons or up to three times the value of the economic benefit derived from the violation, for example, depending on the severity of the violation.

Different meaning of the term "sanction"

Traditionally, in German supervisory law the term "sanction" refers solely to penalties for administrative offences defined in the specialised legislation. Other legal systems do not recognise this restriction; by convention, they also regard preventive measures as sanctions. This makes it difficult to compare statistics and repeatedly causes misunderstandings. For statistical purposes, BaFin recognises only administrative offence proceedings as sanctions, while other countries use this as an umbrella term for all or numerous legal supervisory measures carrying penalties.

Not condemnation but a reminder to meet obligations

Preventive and punitive administrative actions can be taken against one and the same party for the same violation. In neither case is this a disciplinary measure; no condemnation is intended and the purpose is not to retaliate for an injustice done. Preventive administrative action aims to prevent or remedy an imminent or identified irregularity using administrative law means (averting threats). Punitive administrative action sanctions a violation of the law by imposing an administrative fine as an emphatic reminder to meet obligations in due compliance with the law.

BaFin compared internationally

An issue that is frequently raised is whether the administrative fines imposed by BaFin might be far too low when compared internationally. In the Anglo-American legal system (unlike in Germany), substantial fines or settlements running to tens or hundreds of millions are common, with payments and settlements in the billions in isolated cases.

Any attempt to compare the amounts of the administrative fines must take into account the significant differences in legal traditions, legislative frameworks and assessment methods. As described above, an administrative fine serves as a reminder to meet obligations, not condemnation. In addition, German law does not allow for the possibility of

44 For the administrative fines, see 1.5.3, 3.2 and chapter V 7. For BaFin's new WpHG Administrative Fine Guidelines, see chapter V 1.2.

45 See chapter III 2.4.3, chapter V 1.2 and BaFin website at www.bafin.de/dok/9065116.

46 See section 17 (4) of the Act on Breaches of Administrative Regulations.

administrative fine proceedings being concluded by way of a settlement without any finding of fault, as is sometimes the practice at supervisory authorities in the United States and the United Kingdom. Furthermore, gross violations of supervisory laws are frequently defined as criminal offences in Germany and are prosecuted by the competent public prosecutor's office, which prevents them from being pursued separately by BaFin.

For these reasons and others, past administrative fines have been comparatively moderate. Nevertheless, as mentioned above, European legislators followed suit after the financial crisis in 2007/2008.

Disclosure requirements

From the standpoint of those subject to supervision, it is not just the measures themselves that are a burden, but also their statutory disclosure. Depending on the measure, such a disclosure may well have considerable effects, for example influencing a company's share price. However, the disclosure of supervisory measures, for instance on the basis of section 60b of the Banking Act, is not an automatic procedure. Rather, the precondition is, in general, that the measure is final, i. e. that no further appeal for relief may be made.[47] In addition, it must be ensured that there is no invasion of personal privacy or material risk to financial market stability and that no disproportionately high damage will arise when naming the person or undertaking subject to the measure. The same applies to the publication of administrative fine decisions that have become final.

BaFin's actions are appropriate

In summary, it must be noted that legislators have provided BaFin with a wide range of both preventive and punitive powers that it uses appropriately and with caution. The persons and undertakings subject to such interventions can have these reviewed; objection and complaint procedures ensure that proceedings are subject to checks by authorities and the courts, and by exercising interim relief, cases can be decided by a court on a preliminary basis within a short period of time. Indeed, legal recourse ranges from administrative courts of the first and second instance, through the Federal Administrative Court (*Bundesverwaltungsgericht*) to the European Court of Justice. By contrast, cases concerning administrative fines are governed by civil law.

Conclusion

Record criminal fines arouse curiosity and attract attention. In contrast to Anglo-American jurisdictions, the German legal system does not traditionally provide for such criminal fines, even if the available scale of administrative fines now makes comparatively high fines possible. However, this does not mean that supervision in Germany is less efficient – it is just not as conspicuous.

47 This is not the case e. g. under section 26b of the German Capital Investment Act (*Vermögensanlagengesetz*) or for disclosures under the Securities Trading Act.

3.2 Administrative fine proceedings initiated by BaFin

In 2016, BaFin initiated a total of 424 administrative fine proceedings[48] (see info box "New administrative fine proceedings initiated by BaFin").

The proceedings were launched against natural persons, payment agents, credit institutions, insurance undertakings, payment institutions and institutions engaged in finance leasing and/or factoring[49], and – where applicable – also against their responsible persons. These concerned violations of the provisions of the German Money Laundering Act (*Geldwäschegesetz*), the German Banking Act (*Kreditwesengesetz*), the German Insurance Supervision Act (*Versicherungsaufsichtsgesetz*), the German Capital Investment Act (*Vermögensanlagegesetz*), the German Securities Trading Act (*Wertpapierhandelsgesetz*) the German Securities Prospectus Act (*Wertpapierprospektgesetz*) and the Germany Payment Services Supervision Act (*Zahlungsdiensteaufsichtsgesetz*) that are punishable by a fine.

Amount of the administrative fines

Administrative fines totalling €3,275,095 were imposed across all of BaFin's directorates in 2016 (see info box "Administrative fines imposed by BaFin").

Administrative fines imposed by BaFin

In 2016, BaFin imposed administrative fines totalling **€3,275,095**:

Administrative fines totalling **€705,095** were attributable to the Banking Supervision (including money laundering prevention) and Insurance Supervision Directorates.

The Securities Supervision Directorate imposed a total of **€2,570,000** in administrative fines.

New administrative fine proceedings initiated by BaFin

BaFin initiated **424** administrative fine proceedings in 2016:

- **136** were attributable to the Banking Supervision (including money laundering prevention) and Insurance Supervision Directorates[50],
- **288**[51] were attributable to the Securities Supervision Directorate.

3.2.1 Administrative fine proceedings – Securities Supervision

In 2016, BaFin's Securities Supervision Directorate initiated a total of 288[52] new administrative fine proceedings for violations of capital markets law[53], with 1,106 proceedings still pending from the previous year. BaFin concluded 114 proceedings with administrative fines totalling €2,570,000[54] (see info box "Administrative fines imposed by BaFin").

One focus for Securities Supervision is violations of the obligation to publish ad hoc disclosures. BaFin launched 21 proceedings in this area, of which it concluded a total of 20. BaFin discontinued 7 proceedings and imposed an administrative fine in 13 proceedings. The highest administrative fine in this area was €195,000[55].

48 Proceedings under the Act on Breaches of Administrative Regulations (*Ordnungswidrigkeitengesetz*).

49 Section 1 (1a) sentence 2 nos. 9 and 10 of the Banking Act.

50 These proceedings were initiated by the Internal Administration and Legal Affairs Directorate.

51 These include the figures stated in 1.5.3 and chapter V 7.

52 Including the figures stated in 1.5.3 and chapter V 7.

53 This includes violations of the Securities Trading Act, the Securities Acquisition and Takeover Act, the Securities Prospectus Act, the Capital Investment Act and the Banking Act. In 2016, BaFin did not initiate any administrative fine proceedings for violations of the Securities Acquisition and Takeover Act.

54 This total includes the administrative fines stated in 1.5.3 and chapter V 7.

55 See chapter V 7.2.

3.2.2 Administrative fine proceedings – Banking and Insurance Supervision

Proceedings against agents

BaFin launched 61 proceedings against agents within the meaning of section 1 (7) of the Payment Services Supervision Act in the year under review.[56] BaFin issued 48 administrative orders imposing a fine in these 61 proceedings and other administrative fine proceedings pending from previous years against agents. In 2016, 47 administrative orders imposing a fine on agents became final, of which one in a preliminary hearing following a permissible appeal and one further order as the result of a decision by the Local Court (*Amtsgericht*). At the time of going to press, 2 administrative fine proceedings against agents were pending a preliminary hearing following a permissible appeal. 19 others were concluded using the warning procedure[57] since, once the investigations were complete, the administrative offences in each case were able to be judged as still insignificant. BaFin has discontinued a further two proceedings.[58]

In 2016, BaFin imposed fines totalling €165,895 against agents within the meaning of section 1 (7) of the Payment Services Supervision Act.

Other proceedings

In the year under review, BaFin[59] initiated 75 proceedings in accordance with the Act on Breaches of Administrative Regulations as a result of breaches of the provisions of the Money Laundering Act, the Payment Services Supervision Act, the Banking Act and the Insurance Supervision Act that are punishable by a fine against credit institutions, insurance undertakings, payment institutions and institutions that engage in finance leasing and/or factoring[60]. Of these, 70 were attributable to the Banking Supervision Directorate (including 20 to the Department for the Prevention of Money Laundering) and 5 to the Insurance Supervision Directorate.

In the year under review, BaFin issued 24 administrative orders imposing a fine in these proceedings and others pending from previous years: 22 in the Banking Supervision Directorate (including 9 in the Department for the Prevention of Money Laundering) and 2 in the Insurance Supervision Directorate.

In 2016, 20 administrative orders imposing a fine became final: 18 from the Banking Supervision Directorate (including 7 proceedings from the Department for the Prevention of Money Laundering) and 2 from the Insurance Supervision Directorate. In addition, 1 administrative order imposing a fine became final in a preliminary hearing following a permissible appeal and 1 as the result of a court decision, both of these from the Banking Supervision Directorate (of which 1 from the Department for the Prevention of Money Laundering).

6 proceedings were pending a preliminary hearing at the time of going to press: 4 in the Banking Supervision Directorate (of which 2 from the Department for the Prevention of Money Laundering) and 2 from the Insurance Supervision Directorate. 19 proceedings were discontinued: 17 from the Banking Supervision Directorate (including 5 from the Department for the Prevention of Money Laundering) and 2 from the Insurance Supervision Directorate. 16 of these proceedings were discontinued in accordance with the principle of discretionary prosecution (all from the Banking Supervision Directorate, including 4 from the Department for the Prevention of Money Laundering).

Amount of the administrative fines

In 2016, BaFin imposed a total of €539,200 in administrative fines against credit institutions, insurance undertakings, payment institutions

56 These proceedings were initiated by the Internal Administration and Legal Affairs Directorate.

57 Section 56 of the Act on Breaches of Administrative Regulations.

58 See section 47 (1) of the Act on Breaches of Administrative Regulations.

59 These proceedings were initiated by the Internal Administration and Legal Affairs Directorate.

60 Or against their responsible persons.

and institutions that engage in finance leasing and/or factoring, and – where applicable – also against their responsible persons, for violations of the Money Laundering Act, the Payment Services Supervision Act, the Banking Act and the Insurance Supervision Act.

4 Money laundering prevention

4.1 FATF guidance

In October 2016, the Financial Action Task Force (FATF; see info box) issued guidance on the money laundering law requirements for correspondent banking services. BaFin was represented in the FATF working group that prepared the guidance in cooperation with the Financial Stability Board (FSB).

In particular, the paper specifies which forms of correspondent banking are viewed as more and which as less risk-inherent. The aim is to increase institutions' understanding of supervisory measures.

The guidance is part of an initiative managed by several international organisations to investigate and take actions to address the decline in correspondent banking services observed for several years. The FSB had already developed a comprehensive action plan on this issue in November 2015.

A decline in correspondent banking relationships may result in a situation where individual regions in the world are excluded from the global payments network. This would jeopardise efforts to ensure the most comprehensive possible financial inclusion for all of the world's population.

BaFin published a translated version of the guidance on its website.

FATF

FATF is the Financial Action Task Force on Money Laundering. FATF is headquartered at the Organisation for Economic Co-operation and Development (OECD) in Paris, and since its foundation in 1989 has been a leading international body for money laundering prevention. Germany held the presidency of FATF for a year until June 2003. The German delegation generally includes representatives of BaFin. The FATF currently comprises members representing 36 countries and international organisations.

Additional staff for anti-money laundering supervision

Since 2016, BaFin's department for the prevention of money laundering has been strengthened by a new specialist division in Frankfurt am Main. BaFin thus laid a key foundation in 2016 to carry out more and more of its own audits going forward, including at credit institutions. At the end of 2016, BaFin's control bodies approved a further increase in human resources at the department for the prevention of money laundering in 2017 aimed at further enhancing BaFin's capabilities in money laundering prevention. These measures are based on the recommendations of the Financial Action Task Force and its guidance on good supervisory practices for the effective monitoring of anti-money laundering and combating terrorist financing. They also

comply with the risk-based supervision (RBS) requirements of the Fourth EU Anti-Money Laundering Directive[61].

Money laundering prevention at banks

BaFin carried out special audits and accompanied audits on 30 occasions in 2016. At some banks, the auditors noted that suspicious transaction reports were not always issued without undue delay, as specified in the German Money Laundering Act (*Geldwäschegesetz*). BaFin can punish such violations with an administrative fine.[62]

At larger credit institutions that have operations in Switzerland, BaFin's focus concerning the audit of the financial statements for 2016 was on the group-wide implementation of anti-money laundering (AML) requirements. The auditors are tasked with examining the extent to which banks comply with these requirements with respect to the specific legal system in Switzerland.

Money laundering prevention at insurers

BaFin carried out five on-site inspections at life insurers in 2016. It emerged that the AML officers at some undertakings had not included all departments in their precautionary measures. In one case, an AML officer was unaware that the undertaking had petty cash funds. At another insurance undertaking, the mortgage department was not audited. In addition, several undertakings repeatedly failed to ensure sufficient or even any documentation of source of funds reviews on incoming payments, including of large sums. The reason for deficiencies in prevention is often that insufficient time and human resources are available to AML officers, who are subject to increasing demands due to growing legal requirements and new knowledge gained from supervisory practice. Therefore, BaFin frequently considers it necessary for insurance undertakings to ensure a corresponding increase in staff levels. The undertakings are notified of such expanded requirements as part of the audit.

Enhanced anti-money laundering supervision at leasing and factoring institutions

Leasing and factoring institutions – the so-called Group V institutions – are subject to the requirements of the Money Laundering Act in addition to their duties under the Banking Act (*Kreditwesengesetz*). In 2016, BaFin stepped up its monitoring of activities to prevent money laundering, terrorist financing and other punishable offences at Group V and other financial services institutions. Specifically, this means that the internal money laundering prevention measures at a number of institutions were audited in more detail through systematic sampling. BaFin identified considerable deficiencies in some cases, both in implementing the statutory requirements and in the informational value of audit reports for annual financial statements. As a consequence, BaFin requested further information and assessments from the auditors. The most frequent deficiencies were insufficient documentation and incomplete risk analyses, which must be updated on an annual basis.

Account information access procedures in accordance with section 24c of the Banking Act

Section 24c (1) of the Banking Act requires credit institutions, asset management companies and payment institutions to maintain a file recording certain account master data. 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 where necessary to perform its supervisory duties. Upon request, BaFin also provides information from the account information access file to the authorities listed in section 24c (3) of the Banking Act (see Table 6 on page 63).

4.2 Second Payment Services Directive

The Second Payment Services Directive[63] entered into force in mid-January 2016.

61 Directive 2015/849/EU, OJ EU L 141/73.

62 For sanctions, see 3.2.

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

Table 6 Account information access procedures in accordance with section 24c of the Banking Act

Recipient	2016*		2015**	
	absolute	in %	absolute	in %
BaFin	781	0.6	1,183	0.9
Tax authorities	13,549	9.9	13,003	9.7
Police authorities	88,322	64.4	86,702	64.7
Public prosecutors	26,850	19.6	25,851	19.3
Customs authorities	7,307	5.3	6,915	5.2
Other	375	0.3	301	0.2
Total	**137,184**	**100**	**133,955**	**100**

* As at 31 December 2016
** As at 31 Dezember 2015

European legislators are pursuing the objective of further developing the European internal market for electronic payments. The Directive governs the operations of payment service providers and replaces the Payment Services Directive dating from 2007[64]. In substance, the provisions are adapted to innovative online and mobile payment processes. New information and liability requirements are aimed at improving customer protection. The Directive also revises the authorisation requirement with respect to the continuing digitalisation. It amends the definition of payment services accordingly and specifies exclusions.

In principle, the Directive applies to all payment services provided within the European Union (EU). As in the previous Directive, it distinguishes between privileged payment service providers (which are exempted from applying certain requirements of the Directive with consideration to their specific statutory responsibilities or existing institutional supervision) and payment institutions that are also subject in particular to the authorisation requirement and ongoing supervision in accordance with the Directive.

In accordance with the definition, payment services serve to settle payments. Banks are classed as traditional payment service providers. However, start-ups with novel business concepts, such as fintech companies[65], are increasingly making a début.

The EU member states must transpose the Directive into national law by 13 January 2018. Certain IT security requirements will only be mandatory for undertakings 18 months after a delegated regulation enters into force, i. e. at the earliest in October 2018.

Revision of the authorisation requirement

The Directive newly classifies two business activities – payment initiation services and account information services – as payment services, and these will generally be subject to mandatory authorisation or registration going forward. Both services are based on online banking. When customers make an online purchase, they can initiate the payment order by means of a payment initiation service. This transmits the payment order to the merchant without taking possession of the customers' money. Account information services provide users with consolidated information on their payment accounts.

The digital payments business will no longer be a payment service subject to separate standards

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

65 See 5.1.

and requirements. However, this does not mean that it will cease to exist without replacement, but rather will be merged in existing and new definitions of payment services.

The specification of exemptions concerns in particular payment instruments with limited fields of application and certain payment transactions by providers of electronic communications networks or services that do not exceed a specific threshold. Although the providers covered by these exemptions do not require authorisation, they must report their transactions to BaFin.

Authorisation procedure

The Directive also governs the authorisation procedure for payment institutions. This corresponds to the current procedure but with several additions.

As before, payment institutions must submit an authorisation application to the supervisory authority, present their business models and enclose a viable business plan. Going forward, undertakings will also be required to submit their security policy documents. These include disclosures on how they handle security incidents and security-related customer complaints, how they process sensitive payment data and how they intend to ensure business continuity in crisis situations and collect specific statistical data.

Another new feature is the registration procedure for account information services.

Payment initiation and account information services

The new Directive also includes specific provisions regarding payment initiation and account information services. Going forward, credit institutions will be required to grant the new service providers access to the payment accounts managed by them in online banking. Depending on their business models, these service providers will have to comply with specific requirements concerning access to the payment account and account information. Clear identification vis-à-vis the institution managing the payment account is necessary when accessing the account.

Payment initiation and account information services must ensure that personalised security credentials are not accessible to any party other than the user and issuer. They must be transmitted through safe and efficient channels.

In addition, payment initiation and account information service providers must hold professional indemnity insurance.

Strong customer authentication

The amendments contain specific security requirements for payment service providers in relation to executing payments; these are aimed at better protecting customers against fraud and abuse. In certain cases, for instance when payers initiate electronic payment transactions, payment service providers will in future have to request strong customer authentication of the payer. This requires a minimum of two elements from the categories "knowledge" (e. g. a password), "possession" (e. g. a payment card) and "inherence" (e. g. a fingerprint); the elements must be independent of each other. In other words, the non-fulfilment of one criterion may not compromise the reliability of the others. Where online payments are concerned, the authentication process must also include elements that dynamically link the payment transaction to a specific amount and a specific payee.

On 23 February 2017, the European Banking Authority published a draft of the regulatory technical standards that will govern the technicalities of secure communication and the requirement for and exemptions from strong customer authentication.

Allocation of liability

The new Directive stipulates differentiated requirements for notification, evidence and liability with respect to unauthorised payment transactions. Unauthorised payment transactions are those that are initiated using lost, stolen or otherwise misappropriated payment instruments. Going forward, the aim

is for the payer to bear an excess amounting to a maximum of €50 in cases of ordinary negligence.

Strengthening payers' rights

The Directive strengthens the payer's legal rights in other ways, too. To date, the common practice in Germany whereby consumers can unconditionally request a refund within eight weeks of a direct debit from their accounts was only agreed in the contract between the bank and the customer; for SEPA direct debits in euros, this refund right is now also laid down in law.

Businesses frequently charge considerable fees for using certain means of payment, in particular credit cards. The Directive prohibits such charges for payments made using SEPA credit transfers and SEPA direct debits, and for the majority of card payments. The only exceptions are company cards and cards issued under so-called three-party schemes; however, the most popular debit and credit cards in Germany are issued under four-party schemes.

Customer information

The new information requirements contained in the Directive will result in more transparent contractual terms. Cash withdrawal services will inform customers on site of all charges and fees to withdraw cash.

The European Commission intends to produce an electronic guidance notice by January 2018 that lists the rights of consumers in respect of payment services in a clear and easily comprehensible manner. The EBA will set up a Europe-wide electronic register of payment institutions and payment service agents, in which the national registers will be included.

5 Digitalisation

5.1 Fintech companies

The BaFin fintech project

In December 2016, BaFin successfully completed the fintech project that it had launched at the end of 2015 (see info box "What are fintech companies?" on page 66). One objective of the project was to ensure that BaFin handles fintech companies and their supervisory concerns appropriately. Another aim was to provide the companies – which often feature a certain start-up culture – with guidance in order for them to better understand BaFin's supervisory viewpoint. Depending on their business models, fintech companies also require authorisation from BaFin and must meet the relevant supervisory requirements. The principle of "same business, same risk, same rules" applies, in combination with the principle of proportionality.[66]

It became clear as the project progressed that the use of new technologies is also becoming ever more important for the established financial industry, which is increasingly responding to the challenges of digitalisation. For BaFin, continuing digitalisation is consequently a wide-ranging topic that it has to understand in detail to address the associated regulatory and supervisory issues adequately and with due consideration of the affected companies.

Information and communication

In order to provide fintech companies with an introduction to the range of issues covered by supervision, BaFin's website at www.bafin.de[67] offers customised, compact information for fintech companies which addresses questions regarding the most commonly used fintech

66 See BaFin President Felix Hufeld on fintech companies, 2015 Annual Report, page 39 ff.

67 www.bafin.de/dok/8054674.

business models at the present time (see info box "Common fintech business models"). This information can be understood without in-depth legal knowledge and is provided in German and English.

BaFin has also made available a contact form on its website that entrepreneurs can use to contact the authority with specific questions. The form is also used to determine the competent unit within BaFin and to quickly designate a specific contact person.

BaFin also supports direct dialogue by participating in various events and being available to answer questions. BaFin hosted its own conference, BaFin-Tech 2016, in June 2016.[68]

BaFin is further expanding its range of information and communication for fintech companies, and is adapting this to new developments. Innovative business models, too, can only become permanently established on the market when the entrepreneurs are familiar with supervisory requirements.

What are fintech companies?

The term *fintech* is a portmanteau of *financial services* and *technology*. As yet there is no precise definition. Fintech companies are generally understood to be young companies that use technology-based systems to offer specialist financial services tailored to the needs of specific customer groups. Fintech companies follow the trend towards digitalisation and personalisation. They focus on customer-friendly, quick and convenient applications. However, fintech companies do not just compete with traditional financial services providers such as banks, insurers and investment firms, but to some extent also supplement their service offering. They are driving digital progress throughout the financial market.

Common fintech business models

- Alternative payment methods
- Automated portfolio management
- Blockchain
- Crowdfunding
- Crowdinvesting
- Crowdlending
- Insurtech companies[69]
- Automated investment advice
- Signal trading and automated order execution
- Capital investments information sheet
- Virtual currency

Innovative financial technologies

During the project it once again became clear that fintech companies draw on state-of-the-art technologies to pursue their innovative business models. Big data, artificial intelligence, distributed ledger technology and blockchain[70] are just some of the buzzwords that are frequently used in this context. These technologies are driving forward the digitalisation of the financial market, and thus present both an opportunity and a challenge for established financial institutions. New issues are coming into play for BaFin, too, both in supervisory law in general and with respect to collective consumer protection.

A new division for innovative financial technologies

A newly established unit within the President's Directorate will concentrate on innovative financial technologies, not only but also because these have increasing importance for established providers of financial services. The unit will work together with the internal BaFin network of experts that has already proven to be successful as part of the fintech project. The new unit is also intended to consolidate the requisite expertise to represent BaFin in national and international regulatory projects dealing with innovative financial technologies.

68 www.bafin.de/dok/8129358.

69 See 5.2.

70 www.bafin.de/dok/7860066.

5.2 Insurtech companies

For decades now, digitalisation has already been bringing about constant change in the insurance industry's core processes. In addition, intensified data processing enables greater risk adjustment in premium rates and more precise targeting.

While the progress of digitalisation in the insurance industry has thus far been stable, many companies fear a disruptive change in the sector. The reason for this is insurtech companies[71], a special form of fintech companies (see info box "Common fintech business models" on page 66). These innovative start-ups seek to use digital processes to establish themselves on the market, and in doing so are accelerating the pace of digitalisation in the insurance industry.

Risk, innovation and speed

A high level of entrepreneurial risk, innovation and speed are the hallmarks of the majority of start-ups. Some manage to hold their own on the market; others fail and some of them try again. This culture of venture, trial and error, failure and fresh starts is difficult to reconcile with the insurance business. It focuses on policyholders and their claims under insurance policies, which are long-term in nature.

For that reason, legislators have imposed stringent requirements on the authorisation of insurance undertakings. Insurtech companies are thus primarily formed along the value chain where they are not subject to supervision by BaFin.

Insurtech companies subject to supervision

As with the term "fintech", there is no legal definition of "insurtech", leaving it open to varying interpretations and meaning that there is no uniform figure for the total number of these companies. Insurtech companies are subject to insurance supervision when they act as risk carriers and thus require authorisation. In its day-to-day supervisory activities, BaFin does not differentiate between established insurance undertakings and insurtech companies. As already explained, the principle of proportionality applies to both.

Pressure on established players

The appearance of new market participants requires that established insurers make business decisions, for example to invest in infrastructure. In doing so, they must ensure that they are capable of managing the risks of the decision with regard to risk-bearing capacity.

Insurtech companies can contribute to promoting transparency and competition in the interests of consumers. They increase the pressure on the established industry to optimise its processes, systems and products. This does not just benefit consumers, but also solidifies the competitiveness and stability of the German insurance market in the long term.

BaFin does not believe that the core insurance business is affected by the new players on the market, since to insure means more in the long term than to be able to act quickly and innovatively on the market. In the age of digitalisation, insurance still only works based on one conventional value: trust.

5.3 IT risks

Information technology is of key significance for the institutions and insurance undertakings supervised by BaFin. It forms the basis for their specialised procedures and processes. The continuing digitalisation in the financial and insurance sectors will further accelerate the technological penetration in these industries and drive forward the shift towards interlinking information technology and business processes. This opens up new opportunities for financial market participants. As described above, the catalyst for this development is innovative tech companies that are competing with established players in the financial and insurance sectors. Existing business models are being challenged, since the new competitors use more modern, flexible IT solutions. They can thus operate with a very competitive IT cost structure and put

71 www.bafin.de/dok/8728920.

pressure on established providers in terms of offering and pricing.

Supervisory focus on risk

Supervisors must also concentrate on the risks that go hand and hand with the continuing digitalisation. In particular, the threat of cyber attacks intensified further in 2016. One only has to think of the increasing threat of ransomware, where for the most part the victims are blackmailed into paying money, of the growing number of denial-of-service attacks that among other things target the availability of online banking services in particular, and of other targeted attacks against specific companies.

Supervisory practice makes it clear that the issue of IT security must continue to be a top priority for the institutions and insurers themselves, as well as for IT service providers, since there is a significant number of legacy IT systems, some of which are vulnerable with respect to potential system failures. Added to this is the fact that companies in the financial and insurance sectors continue to view IT security primarily from the viewpoint of cost, which fails to do justice to the issue from a supervisory perspective.

In-depth analysis of IT security

In 2016, BaFin continued to intensively analyse issues surrounding IT security in the financial and insurance sectors. Naturally, this also includes comprehensive dialogue with other authorities such as the Federal Office for Information Security (*Bundesamt für Sicherheit in der Informationstechnik* – BSI), but also with industry associations and IT service providers from the financial and insurance sectors and beyond. To be able to assess the overall threat situation from a supervisory perspective, BaFin has regularly analysed all information and warnings available to it and continues to do so.

No serious IT failures

An analysis of the reports received by BaFin since the end of 2015 in respect of serious security incidents in payment transactions showed that there have been no serious IT failures in German payment transactions since the reporting requirement came into force. However, there were reports of failures in the IT processes of individual institutions and IT service providers that had significant effects on the availability and integrity of data.

BaFin is currently represented in a wide range of national and international working groups that deal with digitalisation and the cyber threat situation. Of particular note are the findings of the G7 Cyber Expert Group. At the end of 2016, the expert group issued a report specifying eight fundamental elements to increase cybersecurity in the financial sector. These can be used, for instance, as the basis for institutions to develop and implement a cybersecurity strategy. In Germany, the fundamental elements were published on the website of the Federal Ministry of Finance (*Bundesfinanzministerium* – BMF) and others. It is recommended that undertakings and institutions implement the eight fundamental elements.

BAIT

At the national level in 2016, BaFin worked together with the Bundesbank to refine the Minimum Requirements for Risk Management (*Mindestanforderungen an das Risikomanagement* – MaRisk) for banks and, with assistance from the IT expert committee, formulated the Supervisory Requirements for IT (*Bankaufsichtliche Anforderungen an die IT* – BAIT), which is planned for publication as a separate circular.[72] The aim is for BAIT to play a particular role in increasing the awareness of IT risks both within the institutions themselves and with regard to their IT outsourcing providers, and to present what BaFin expects from institutions in the most transparent way possible. BAIT is scheduled to be made available for public consultation in the first quarter of 2017. The MaRisk update had not been published by the time of going to press.

72 Both MaRisk and BAIT set out the requirements of sections 25a and 25b of the Banking Act in greater detail.

6 Market-based financing

6.1 Capital Markets Union

Roadmap for the Capital Markets Union to 2019

The Capital Markets Union remains a key foundation of European integration (see info box). The European Commission continued to advance this project in 2016.

The term "Capital Markets Union" brings together numerous measures. These include a securitisation framework, changes for insurers concerning risk calibration for investments in infrastructure and European long-term investment funds, and amendments to the Regulation on European Social Entrepreneurship Funds (EuSEF) and the Regulation on European Venture Capital Funds (EuVECA). It also includes a European framework for covered bonds and an analysis of the effects of financial market regulation on investors.

Capital Markets Union

The Capital Markets Union is currently one of the European Commission's most important projects in the area of financial market regulation. The prelude was an action plan published on 30 September 2015,[75] in which the European Commission proposed a large number of initiatives. The goal of the Capital Markets Union is a single market for capital that will contribute to increased cross-border risk distribution, deeper and more liquid markets and greater diversity of funding sources for the real economy. The plan is for the capital to benefit small and medium-sized enterprises and infrastructure projects, and promote growth and employment. The Commission intends to set all of the project's core measures in motion by 2019.

In its progress report dated 14 September 2016, the European Commission set out the progress made in implementing the Capital Markets Union. The following serve as examples:

Amendment of the Solvency II regime

Delegated Regulation (EU) 2016/467[73], which entered into force in April 2016 and amends Solvency II, is the first Capital Markets Union measure implemented to promote infrastructure investments. The initiative affects how regulatory capital requirements are calculated; BaFin published corresponding information on "day 1 reporting".[74]

New Prospectus Regulation

In December 2016, the European Parliament and the Council paved the way for a new Prospectus Regulation that will make it easier for small and new enterprises in particular to access the capital market through expanded exemptions and partially relaxed prospectus requirements[76].

Venture capital funds/social entrepreneurship funds

In July 2016, the European Commission published a proposal to amend the Regulation on European Social Entrepreneurship Funds and the Regulation on European Venture Capital Funds. This is a key element of the Capital Markets Union action plan and is aimed at helping diversify sources of funding and free up capital by simplifying access for investors, fund managers and portfolio companies to EuVECA and EuSEF funds.

New securitisation framework

The European Commission intends to reinvigorate the securitisation market to improve funding for infrastructure projects as

73 Delegated Regulation (EU) 2016/467, OJ EU L 85/6.

74 www.bafin.de/dok/8059278.

75 See BaFinJournal October 2015, page 10, and see BaFin website at www.bafin.de/dok/8970492, and the 2015 Annual report, page 35 ff. The action plan is available at http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52015DC0468&from=DE.

76 See chapter V 1.5.

well as SMEs, and to expand the investor base. For this purpose, the Commission published a package of two legislative proposals in September 2015.

One of these is a cross-sectoral securitisation regulation that will be applicable to all securitisations. It contains due diligence requirements for investors, retention requirements for originators, sponsors or original lenders, and transparency requirements.

In addition, the regulation defines the criteria for simple, transparent and standardised securitisations (STSs) and outlines a specific supervisory architecture for them. Under the Commission's proposal, the European Securities and Markets Authority would maintain a publicly available list showing which securitisations are STSs. This list is intended to be based on a self-assessment by the parties to a securitisation, but modifications may also be made by the competent supervisory authorities. Consultation within the European Parliament took place between the summer of 2016 and the end of the year, with the discussion focusing in particular on the amount of the risk retention. The trilogue negotiations began in January 2017.

The plan is for banks to face lower regulatory capital requirements for STS securitisations than for other securitisations. The second legislative proposal therefore concerns the Capital Requirements Regulation (CRR). The Commission intends to amend it to make banks' capital requirements for securitisation exposures more risk-sensitive, which also includes the simplifications for STS securitisations already mentioned. Similar arrangements are to be put in place for insurers. The supervisory treatment of securitisations for insurers is specified in a delegated act to Solvency II. BaFin believes that it is imperative for the lessons learned from the financial crisis to be taken into account when developing a new securitisation regime. In this regard, especially this new type of simpler, more transparent securitisation is very welcome.

Consultation on covered bonds

As part of its efforts to create the Capital Markets Union, the European Commission held a consultation on covered bonds which lasted until the beginning of 2016. Based on the consultation and as part of the upcoming mid-term review of the Capital Markets Union in June 2017, the Commission intends to present the legislative amendments that may be necessary to help develop the market for covered bonds throughout the EU. The Commission's assessment in the consultation paper is that the market is currently fragmented as a result of national regulations. It attributes this primarily to the different national jurisdictions and supervisory practices. However, these national differences also stemmed from the close link between the regulations on covered bonds and the non-harmonised insolvency laws in the member states. As part of the consultation process, the German delegation emphasised in particular the great significance of the market for local *Pfandbriefe* and the important role that these bonds play in funding. Should EU law be modified, particular care must be taken not to adversely affect well-functioning markets for covered bonds such as the German *Pfandbrief* market.

7 International supervision

7.1 Bilateral and multilateral cooperation

BaFin entered into further memoranda of understanding (MoU) in 2016 (see appendix, page 239), including for instance an agreement with the Capital Market Authority (CMA) in Lebanon. BaFin also negotiated an MoU with the Securities & Exchange Organisation (SEO) in Iran. Both memoranda govern cooperation between the authorities in issues surrounding

securities supervision (see info box "Memoranda of understanding").

BaFin has also entered into a memorandum of understanding with the United States Commodity Futures Trading Commission (CFTC) concerning closer cooperation in securities supervision. The two supervisory authorities agreed to exchange information.

In the area of banking supervision, BaFin agreed an MoU with the Banking Agency of the Federation of Bosnia and Herzegovina and the Banking Agency of Republika Srpska. The subject matter of the agreement includes the exchange of information on credit institutions and local supervisory visits.

In the year under review, BaFin also cooperated intensively on a technical level with a large number of countries such as Vietnam – primarily in issues relating to securities supervision – and Ukraine.

BaFin and the Deutsche Bundesbank also continued their technical cooperation with the Bank of Kosovo in 2016; this well-functioning relationship has been in place for years. The two authorities held a joint seminar in Kosovo that addressed cutting-edge, risk-based banking supervision. German development agency Gesellschaft für Internationale Zusammenarbeit GmbH (GIZ) also took part in the multi-day event.

In addition, BaFin held specialist seminars in 2016 as a member of the European Supervisory Education Initiative (ESE). These events addressed financial conglomerates and consumer protection.

In the field of multilateral cooperation, BaFin supports the development and implementation of the Enhanced Multilateral Memorandum of Understanding (EMMoU) of the International Organization of Securities Commissions (IOSCO). The expanded text now includes the so-called ACFIT powers: obtaining audit papers, compelling attendance for testimony, advising on freezing assets on behalf of a foreign supervisor, and obtaining and sharing internet service provider and telephone records. The objective is to ensure effective enforcement of securities law, including in light of the ongoing globalisation, growing interconnectedness and technical progress. BaFin will be involved in its implementation, which will start in 2017.

Memoranda of understanding

BaFin agrees memoranda of understanding (MoU) with other supervisory authorities. These serve as the formal basis for the signatory authorities to cooperate and exchange information on credit institutions, investment firms and insurers that operate on a cross-border basis. A distinction must be drawn between general abstract MoUs, which are the rule, and institution-specific MoUs. In turn, these can be sector-specific or cross-sectoral.

7.2 IMF report

In June 2016, the International Monetary Fund (IMF) published its latest report on the stability of the German financial sector, which it had scrutinised as part of the Financial Sector Assessment Program (FSAP).

Clean bill of health for the German financial sector

Overall, the IMF gives the German financial sector a clean bill of health. The IMF paints a picture of an established financial system in Germany that is stable and robust overall, both in terms of the general stability situation and of structural issues such as crisis management, supervisory regime, macro-prudential tools and resolution and recovery.

The IMF report emphasised the significance of the German financial sector for the financial stability of Europe as a whole. Moreover, in the IMF's view, Germany's sovereign bond market functions as a global safe haven and is a key international benchmark.

Overall, the IMF's assessments are broadly consistent with those of all relevant German and European authorities. However, the IMF takes a significantly different view regarding individual issues.

Risk and stress tests

According to the IMF, the low interest rate environment in particular poses risks to the profitability of banks and insurers. Furthermore, a global growth shock, a sharp economic downturn in emerging markets or renewed tensions in the euro area could lead to a rapid hike in risk premiums and asset price volatility. This in turn would increase the probability of financial risks arising in Germany, as well as cross-border contamination risk. However, both banks and insurers did well in the IMF stress tests.

Banking regulation and supervision

Overall, the IMF's assessment of the regulation and supervision of banks in Germany, the first country to have been assessed under the Single Supervisory Mechanism (SSM), is positive. The downgrades as against the 2011 assessment were due to new weightings and the Core Principles for Effective Banking Supervision by the Basel Committee on Banking Supervision (BCBS) being tightened.

The downgrades were also are linked to the IMF assessors criticising and attaching particular weight to the German two-tier system, where the management board and supervisory board are two different entities. However, the BCBS itself (as the author of the core principles relevant in this regard) had already classified this as equivalent to the one-tier system, under which a single governing body performs both functions.

Financial market infrastructure

The review of compliance with the supervisory standards for central counterparties (CCPs) was very satisfactory. The IMF views the international Principles for Financial Market Infrastructures (PFMI) as almost fully met.

Insurance regulation and supervision

The IMF also reached a positive conclusion on the insurance sector, although it noted that the low interest rate environment is exacerbating the low profitability of the business models. Despite the challenges and the implementation of Solvency II, however, the IMF reported that life insurers retained significant loss absorption capacity.

Regulation and supervision of collective investment undertakings

The IMF assessed BaFin's supervision of collective investment undertakings as firm but fair. In terms of liquidity management, the IMF recommended further tools in this area. The current legal regime allows German asset managers only two options: the suspension of redemptions or redemption in kind. Changes in legislation would be required to introduce additional liquidity tools.

Combating money laundering and terrorist financing

The IMF specifically acknowledged the significant progress made with regard to the definition of money laundering as a criminal offence in accordance with section 261 of the German Criminal Code (*Strafgesetzbuch*). Extending the range of predicate offences to include so-called self-laundering means that the definition of the criminal offence now largely corresponds with international standards. In addition, the IMF considers the automated account information access procedure to be a highly effective tool.

Bank resolution and crisis management

According to the IMF, the crisis management framework has been significantly strengthened by transposing the EU Bank Recovery and Resolution Directive (BRRD)[77] and Deposit Guarantee Schemes Directive (DGSD)[78] into German law. This fulfils the recommendation made by the IMF during the previous FSAP to establish a uniform guarantee of € 100,000 per

77 Directive 2014/59/EU, OJ EU L 173/190.

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

depositor and to ensure adequate pre-funding for deposit guarantee schemes. The EU Deposit Guarantee Schemes Directive contains harmonised rules on guarantee limits and the funding of protection schemes.[79]

79 See 2015 Annual Report, page 52 ff.

8 Risk modelling

8.1 Risk models in the banking sector

Two years ago, the public discussion surrounding bank management and regulation gave the impression that all models were fighting for survival. The demand was for simple regulations that would produce comparable results at all banks. This only seemed possible with standardised approaches.

Just as it is not possible to do without models as the basis for weather forecasts, banks and supervisory authorities cannot manage without them either. On the contrary: the latest developments, such as to accounting standard IFRS 9[80], show that the use of models is increasing, even outside their original areas of application.

Rather, what is critical is that they are only used where there is a sufficient basis for forecasts, the recipient of model outputs is aware of their boundaries and the associated risks and limitations are taken into account.

Two major developments in 2016 focused on both aspects: firstly, the reform of the Basel framework on internal models entered its final stages. And secondly, 19 national competent authorities and the European Central Bank (ECB) launched the Targeted Review of Internal Models (TRIM) project under the Single Supervisory Mechanism.

The following reports on the current and intermediate results.

80 See 9.

8.1.1 Reform of the Basel framework on internal models

The first approval of internal models for market risk (in 1996 under the market risk amendment to the Basel framework) and for credit and operational risk (in 2004 under the Basel II framework) led the banks to significantly improve the quality of the data used for the models and their risk management processes in order to create an appropriate foundation for the modelling and supervisory approval of risk models. Since then, many credit institutions have prepared for the review of these models in projects that often last for years. Conversely, the internal models have helped improve risk management, in particular through intense risk analysis, high-quality data, risk measurement appropriate to the risk profile and decision-oriented risk reporting. The key requirement for this was and remains the risk sensitivity of the models used.

However, the focus in recent years has not been on the appropriateness of an internal model for a specific institution, but rather comparability of model outputs across different institutions. Internal models were seen as a potential source of undesired variation in capital requirements.

Range determined by outliers

In principle, certain international and European benchmark reviews have shown that the range of risk-weighted assets determined is quite acceptable for the vast majority of banks reviewed. The range actually observed is primarily determined by a small number of outliers, and overall a large proportion of the

differences are due to the different risks faced by the banks[81].

The BCBS is working on stemming the remaining undesired variation and refining the regulatory framework for banks – Basel III – as appropriate. In doing so, the BCBS is balancing the three goals of "risk sensitivity, simplicity and comparability".

After publishing a progress report in November 2015 on the work since the financial crisis to reform the regulatory framework, in March 2016 the BCBS published a consultative document on reducing variation in credit risk-weighted assets by means of constraints on the use of internal model approaches. The proposals contained in the document are based on an analysis of the ability to use internal models to calculate regulatory capital using various criteria such as data availability, modelling techniques and validation.

The consultative document sets out proposals in the following areas:

- Removing or limiting the option to use the internal ratings-based (IRB) approach to calculate regulatory capital for certain portfolios
- Adopting exposure-level floors for certain model parameters for portfolios where the IRB approaches remain available
- Providing specification and guidelines for parameter estimation in IRB approaches to reduce the variability caused by different practices

The document also announces the likely introduction of an output floor for calculating regulatory capital based on the respective standardised approaches. The design and calibration of this output floor is subject to further consultation.[82]

Impact study

In parallel to the consultative document, the BCBS carried out a quantitative impact study to assess issues including the extent to which the proposed amendments can be reconciled with the requirement of the Group of Central Bank Governors and Heads of Supervision (GHOS) that regulatory capital not be significantly increased as a result.

The proposals set out in the consultative document were partially modified based on the additional information gained from the impact study and the discussions held in 2016. The work is already at an advanced stage but nevertheless has not yet been completed. German banks use a relatively large number of internal models compared with their international peers. As a result, supervisory authorities in Germany pay very close attention to this issue. From a qualitative standpoint, the requirements of the model experts at BaFin and the Bundesbank with respect to compliant and professional use of internal models by banks are at the upper end of the regulatory framework; however, it goes without saying that the principle of proportionality is observed.

Risk sensitivity as principle

BaFin is heavily involved in the Basel consultations on internal models and, while it believes that limiting the use of internal models to calculate regulatory capital is indeed reasonable in specific cases, it takes the view that risk sensitivity should not be abandoned as a regulatory principle. BaFin and the Bundesbank thus place great value on retaining the key achievements of internal models.

Internal models are not an end in themselves; rather, they aim to strengthen an institution's risk management. Ultimately, introducing internal models significantly increases the quality of the information available to manage a bank. Alternative, non-risk-sensitive approaches can lead to inappropriate incentives and thus entail the risk of mismanagement.

81 See www.eba.europa.eu/-/eba-publishes-its-regular-assessment-of-eu-banks-internal-model-outcomes.

82 See chapters I 1 and III 1.1.6. The results were still pending at the time of going to press.

Consequently, risk sensitivity and the requirements for the risk management processes should not be sacrificed for standardisation and simplicity. The framework should be as simple as possible but no simpler, since only then can it match the complexity of products and risk profiles.

8.1.2 SSM project TRIM

The overarching objective of TRIM is to rebuild trust in the use of models to calculate risk and capital requirements, which has collapsed since the financial crisis. Likewise, the aim when comparing the model banks is for the same risks to lead to the same capital requirements and for the supervision of these models within the SSM to be harmonised and improved.

Priority areas

The Basel framework and its implementation through the Capital Requirements Regulation are already extremely comprehensive. The EBA has added numerous explanations and interpretations to the legislation. Despite this, member states interpret the framework differently based on their national idiosyncrasies and have developed different supervisory practices. Likewise, the banks are facing challenges due to the complex regulations, and ask for guidance. Thus, a key harmonisation task within the SSM is to identify these differences, understand the specific underlying causes at national level and – where possible – find standardised approaches.

Accordingly, the TRIM project does not address the broad range of issues surrounding model reviews, but focuses on targeting selected topics. Hence its name: "Targeted Review of Internal Models". A project of this scale on the juncture between supervisory framework and supervisory practice must be closely interlinked with the development of regulatory reforms, ongoing supervision of models and regular model reviews.

Project progress

In 2016, various working groups identified the topic areas to be addressed in TRIM and formulated the respective "supervisory expectations" of banks as well as guidelines and instruments for reviewers. These requirements fit within the prescribed regulatory framework.

The "supervisory expectations" form the basis for the TRIM project and the dialogue with the banks. During the project they will be augmented with the experience gained from supervisory consultations and reviews, and towards the end of the project, following a consultation, they will be adopted by the Supervisory Board of the SSM, on which BaFin is also represented.

The dialogue with the banks began in 2016 with topic-related surveys and supervisory consultations, and will be continued on the specific topics in 2017/18 with the conclusion of the supervisory consultations and model reviews.

8.1.3 Conclusion and outlook

The changes to the Basel framework currently pending a decision will not result in the feared eradication of internal models, but rather are expected to allow internal models in those areas where there is sufficient data and information enabling a forecast and review.

One fundamental concern of the Basel framework was to allow internal models as a risk-sensitive approach to calculating capital, which – precisely because of its risk sensitivity – could also be used for risk management. This concern would still be taken into account, although the output floor referred to above could results in constraints on the benefits of using internal models to calculate capital requirements.

The TRIM project makes a key contribution to achieving uniform interpretation and implementation of these rules. TRIM imposes particularly high demands for the regular and comprehensive validation of models and for suitability tests by staff at the banks who are

sufficient in number, qualified and capable of seeing the task through.

In addition, TRIM is a major step towards integrated and harmonised supervision of internal models within the SSM, in which the national supervisory authorities can leverage their proximity to the institutions and their many years of experience with the idiosyncrasies of their banking systems.

The developments presented here will place increased requirements on the use of internal models, which will further strengthen the justified trust in the models. The increased requirements must not remain limited to internal models used in calculating capital requirements, but rather must apply in equal measure to all other models used by a bank.

8.2 Internal models in the insurance industry

8.2.1 Ongoing supervision of internal models under Solvency II

Internal models are one of the key new features of the Solvency II supervisory system that entered into force on 1 January 2016. BaFin has authorised a range of insurance undertakings, upon application, to calculate their solvency capital requirement using their own internal models developed for this purpose, as opposed to the prescribed standard formula. By the end of 2016, BaFin had approved a total of 36 internal models from individual undertakings. Their market share illustrates the significance of internal models (see Table 7 "Approved internal models"). In addition, five German insurance groups use an internal model to calculate their solvency capital requirement at group level.

Models in ongoing supervision

In each instance, the approvals were the result of a six-month decision-making process preceded by a pre-application phase that extended over several years in some cases and involved a large number of on-site inspections. Through its approval, BaFin confirmed that the insurance undertakings met the relevant statutory requirements as of the application date.

Table 7 Approved internal models

As at 31 December 2016

Segment	Approved internal models	Market share*
Property/ casualty	15	55 %
Life	11	42 %
Health	4	38 %
Reinsurance	5	86 %

* Volume calculated using the technical provisions in accordance with the solvency statement.

The capability of an internal model changes, for example with the risk profile of the undertaking. This in turn depends on a considerable number of factors that are both internal and external in nature. Following approval, too, the internal model must remain sufficiently effective in the long term. To ensure this, BaFin must, in the course of the supervisory review process under section 294 of the Insurance Supervision Act (*Versicherungsaufsichtsgesetz*), review on a regular basis whether the undertaking's internal model continuously complies with the applicable requirements (sections 111-121 of the Insurance Supervision Act).

BaFin conceived this element of the supervisory review process – ongoing supervision of internal models – in 2015. Since the beginning of 2016, BaFin has been in contact with the undertakings and gradually developed this concept. Individual agreements on regular exchanges of information on the internal model are agreed, among other things.

Changes to models

An integral part of ongoing supervision is the review of changes to models. In 2016, the first year following initial approval, nearly all undertakings submitted an application for the approval of major adjustments to their internal models, and also notified BaFin

of more minor changes. An unexpectedly large proportion of the ongoing supervision was occupied by processing model changes. This was due on the one hand to the comprehensive reworking by the undertakings in direct connection with the initial approval. For example, insurers remedied minor defects, implemented improvements in their models that they had postponed due to the application, and expanded the internal model's limited scope of application. On the other hand, trends in the (capital) market environment necessitated changes to the models. Time constraints meant that it was not possible in all cases to prepare the decision in a formal application process by means of a pre-application phase.

Comprehensive ongoing supervision

Simply reviewing model changes is not nearly enough, however. To comprehensively assess whether insurers comply with the applicable requirements, BaFin must also review whether the undertaking took an appropriate decision to confirm the model in other areas without amendment. The scope of ongoing supervision of internal models must therefore be appropriately broad.

Congruent requirements for undertakings and supervision

Efficient ongoing supervision builds on knowledge of the model and the experience gained (at present mainly from reviews of the pre-application and application phase), and makes the best possible use of the results of approved internal processes and analyses that determine further development of the model. Legislators therefore designed the above-mentioned duty for BaFin and the requirements on insurers under section 120 (1) of the Insurance Supervision Act to regularly validate their models in a largely congruent manner.

Under the validation, undertakings themselves review their models for weaknesses and identify the resulting need to make adjustments. They submit a detailed self-assessment to BaFin on compliance with the legal requirements. They also notify BaFin in a transparent manner of their decisions to change or not change the model. The validation report, which must be prepared by the undertakings at the minimum on an annual basis, thus presents BaFin with a core starting point for ongoing supervision. BaFin must verify and scrutinise the results.

Broad base of information

BaFin must ensure that, at all times, it has detailed knowledge not just of the internal model, but also – and in particular independently of the model – of the undertaking's risk profile and risk management system. This knowledge is gained from sources such as the own risk and solvency assessment (ORSA), regular supervisory report (RSR) and quantitative reporting templates, as well as from BaFin's own surveys. In addition to this, BaFin has agreed with individual insurers that they will regularly provide a package of information on the calibration of their models.

Benchmarking: a promising instrument

In 2016, BaFin began to evaluate the information under Solvency II that undertakings started to provide on a regular basis during the year. BaFin discusses the results of specific analyses carried out as part of the ongoing supervision of individual undertakings on an overarching basis and integrates these into a benchmark comparison. Such peer reviews can provide valuable insights for the undertaking subject to supervision, for instance when it is necessary to assess undertaking-specific results in comparison with the industry. These analyses can be just as worthwhile for the industry as a whole, for instance when developing methodological approaches to risk measurement or evaluation. In addition, they contribute to consistent supervisory evaluation and practice, and also take into account macro-prudential perspectives.

BaFin also participates in the pan-European benchmark reviews carried out by the European Insurance and Occupational Pensions Authority (EIOPA). The 2016 market risk benchmark study and the two studies on mapping the dynamic

volatility adjustment and the risks from government bonds will be completed during the course of the year.

Efficiency

It is not just the critics of internal models who are aware of their high degree of complexity and individuality, even if this is required to a certain extent. However, what are crucial are the opportunities and new chances that BaFin derives from monitoring these tailor-made risk management tools.

Supervising – and refining – the models on an ongoing basis is unquestionably a costly and challenging task. For BaFin and the undertakings, what matters is ensuring that the exchange of information and associated processes are as efficient and effective as possible, in compliance with all legal requirements. This also – and primarily – applies in view of the limited resources. The experience gained in practice (regarding the interdependent model validation and change processes, for instance) must be leveraged and room for improvement identified. In the long term, efficient and effective ongoing supervision will contribute to the success and market acceptance of internal models.

9 Financial accounting and reporting

EBA impact study on IFRS 9

In 2016, the European Banking Authority (EBA) approached 58 European credit institutions with a comprehensive survey.[83] This was carried out at the beginning of the year and was repeated at the end of the year. The aim was to obtain information on the impact (including on regulatory issues), implementation status, practical handling and any problems arising in the context of implementing IFRS 9[84], the new standard on the accounting for financial instruments at credit institutions.

The survey included both qualitative and quantitative questions on implementing the new standard. Six German institutions were involved: DZ Bank, Landesbank Baden-Württemberg, Deutsche Bank, Commerzbank, Nord/LB and Bayerische Landesbank.

At the time of the first survey, the majority of the surveyed institutions had not yet made significant progress in implementing IFRS 9. The EBA thus made it clear at the beginning of 2016 that the survey would be on a best effort basis.[85] The information provided by the credit institutions must therefore be viewed as preliminary. Based on the feedback received, the EBA issued a report containing an anonymous summary of the credit institutions' main responses, which were as follows:

- The quantitative impact was mainly attributable to the new impairment requirements and less to the new classification and measurement requirements.
  For the median[86], European credit institutions stated that they expect

83 These mainly included those credit institutions that were included in the EBA's key risk indicators sample to prepare the half-yearly Risk Dashboard, which is available online at: http://www.eba.europa.eu/risk-analysis-and-data/risk-dashboard.

84 The abbreviation stands for „International Financial Reporting Standard".

85 Instructions and templates for Impact Assessment of IFRS 9, page 1: "Institutions are invited to complete this exercise on a best efforts basis".

86 As a measure of location, the median corresponds to the middle (central) figure in an ascending list of values. It thus represents the value that divides the figures into two halves. In order to assess the percentage increase in risk provisions and other quantitative issues, the EBA's report is based to a great extent on measures of location and avoids calculating the arithmetical average, since unlike the median this is vulnerable to outliers in the figures reported. In order to ensure comparability with the EBA's statements in the report, the median was also used as the mean value for the German credit institutions.

provisions to increase by 20 %. The figure was 30 % for the 75th percentile[87]. This also corresponds to the responses from the German credit institutions. As a result, the CET1 ratio[88] at European institutions decreases by up to 50 basis points for the median and by 75 basis points for the 75th percentile. German credit institutions also reported that the CET1 ratio would decrease by up to 50 basis points for the median. This figure is also the same for the 75th percentile.

- Overall, the requirements associated with IFRS 9 in respect of data volume and quality are the greatest difficulty for the surveyed European credit institutions. This did not necessarily appear to be the case for the German credit institutions, half of which do not expect any problems relating to data availability.
- Both the respondents overall and the German credit institutions intend as far as possible to leverage existing regulatory processes, models and data, and to build on these. The banks point out that they would potentially have to adapt these models and processes to correspond to the requirements of the new standard.
- Although the credit institutions intend to make use of the practical expedients when implementing IFRS 9, this would happen to varying degrees and in some cases as a backstop if no other information were available. This applies to both the respondents as a whole, as well as to the German credit institutions.

The EBA published the report on its website in November 2016. It simultaneously launched the second survey exercise. Again, the questions concerned both qualitative and quantitative aspects. The deadline for the credit institutions to respond was 15 February 2017.

In view of the approaching effective date of the standard (1 January 2018), there are higher demands on the validity of the information in the second survey. The information is therefore no longer to be supplied on a best effort basis. Following completion of the exercise, the EBA will again publish a report detailing the key findings.

87 The 75th percentile represents the value dividing the upper quarter of data in a range of values sorted in ascending order.

88 CET1 stands for Common Equity Tier 1 capital.

10 Climate change

There is a public debate, not just in this part of the world, about how to sustainably reduce global emissions of pollutants. The impact of climate change is also on the agenda at international organisations such as the World Bank, the Organisation for Economic Co-operation and Development (OECD) and the International Monetary Fund (IMF).

In 2016, the issue reached the financial markets, including due to the resolutions of the United Nations Climate Change Conference (COP 21), which took place in Paris in 2015. The media keenly followed the work of the Task Force on Climate-related Financial Disclosure (TCFD), which was established by the Financial Stability Board. The working group chaired by Michael Bloomberg is expected to issue a final report with recommendations in June 2017.

In addition, a range of well-known academics and organisations addressed climate change and its effects (including for financial market stability) last year. Their work did not just deal with decarbonisation strategies, but also addressed second-round effects, thus bringing the corresponding vulnerability analyses into focus.

In BaFin's opinion, this work in the area of "green finance" must be continued, since it provides approaches to improve the disclosure of financial risks due to environmental issues and to further refine the tools to measure and manage these risks.

BaFin participates in the work, and for this purpose is in constant dialogue with various market players as well as international supervisory authorities and central banks.

III Supervision of banks, financial services providers and payment institutions

1 Bases of supervision

1.1 Finalisation of the Basel III reform agenda

At the request of the G20 heads of state and government, the Basel Committee on Banking Supervision (BCBS) has been working for some time on finalising the post-crisis reform agenda, in particular on the revision of the global capital requirements for banks, known as "Basel III". The central focus of the revision work was on model approaches, which had generated outcomes that were too widely divergent from one another. A number of studies had identified excessive variability in risk-weighted assets and therefore in the regulatory capital derived from models.[1]

However, the variability is not always unintentional. Sometimes the divergences are caused by the business models or by the fact that countries have exercised options permitted at national level. All of this was fed into discussions about the internal ratings-based approach (IRBA). In BaFin's opinion, a healthy scepticism about models is entirely appropriate. Banks have used internal models too frequently for the purpose of optimising their regulatory capital requirements, as shown by the divergences – substantial in some cases – from the applicable standardised approaches. But the deliberate use of internal models to calculate lower capital requirements is only one reason for the noticeable differences from the standardised approaches. The Basel Committee also established that the standardised approaches for credit risk, market risk, counterparty default risk and its pricing (credit valuation adjustment) and operational risk were no longer correctly calibrated to reflect the relevant risks, and adjusted them.

Output floor

Other elements of the finalisation of Basel III were the discontinuation of the advanced measurement approach for operational risk (AMA), a surcharge on the leverage for ratio global systemically important banks (G-SIBs)

1 On this subject, see the EBA's benchmarking exercise at https://www.eba.europa.eu/-/eba-publishes-its-regular-assessment-of-eu-banks-internal-model-outcomes.

and, last but not least, the possible introduction of an output floor in addition to the leverage ratio.

The reason for the output floor is that the Basel Committee wants to ensure that the use of internal models does not result in regulatory capital falling below a specified percentage of the applicable standardised approach. In particular, the output floor is intended to address the issue of gaming risk, i. e. the deliberate use of modelling to lower the regulatory capital requirements. By contrast, the leverage ratio is meant to cover errors in the model.

The negotiations have proven to be difficult. While some states would prefer to dispense with modelling and apply only the standardised approaches to determine regulatory capital requirements, BaFin takes the view that internal modelling makes an important contribution to the analysis, assessment and management of risk. Many risks would remain unidentified without the use of internal models. It is important to retain these benefits.

Reducing excessive variability

In the negotiations, BaFin represented, and continues to represent, the opinion that excessive variability must be reduced, but without losing the advantages of modelling for the purposes of assessing risk. The output floor should therefore only affect outliers and not the bulk of the German banking industry.

Differing national interests have also become evident during the discussions. The differences are partly due to the fact that some risks are measured differently in different countries. For example, it is impossible to compare the default risk on a real estate loan between different countries, since the member states of the BCBS have completely different systems of insolvency law. Default on a credit derivative, however, would have almost identical legal ramifications. This has made, and continues to make, the negotiations particularly difficult, since no country wants to see its markets, major institutions or systemically important banking products restricted by international regulation.

The Basel Committee has resolved to make changes to the IRBA and to the standardised approach for credit risk. It is going ahead with scrapping the AMA and has developed a new standardised approach for operational risk. The leverage ratio for global systemically important institutions will also be introduced, depending on their existing, already known G-SIB capital buffers. These points have been cleared up. The structure and level of the output floor remain unresolved at the present time. In connection with real estate loans in particular, discussions are continuing on specific national circumstances for which there are expected to be either transitional provisions or national options. There is also no agreement at present on the level of the output floor. BaFin's position is that the output floor should be binding on institutions which use models to optimise the regulatory capital requirements. It should not penalise internal modelling to the point that institutions consider it to be no longer worthwhile, but should impose a small number of restrictions on them in the form of higher capital requirements. At the time of going to press, no decisions had been made about the final unresolved issues. The BCBS requires implementation of the whole package to be completed by 2025 – with a few special provisions as in the case of real estate financing.

1.2 European reform package

On 23 November 2016, the European Commission presented a comprehensive package of reform proposals building on the existing regulatory system applying to the financial markets. The aim of the proposals is to reduce risk and enhance financial stability.

The package contains proposals for additions to the Capital Requirements Regulation (CRR) and the Capital Requirements Directive IV (CRD IV) as well as to the Bank Recovery and Resolution Directive (BRRD) and the Single Resolution Mechanism Regulation (SRMR)

which implement global standards into EU law. The Commission stresses that its initiative aims to take into account European specificities and avoid undue impact on the financing of the real economy. The European Parliament and the Council will now consider the legislative proposals.

The Commission's reform proposals are primarily based on elements of the regulatory framework recently agreed by the Basel Committee on Banking Supervision and the Financial Stability Board (FSB). Their principal objective is to enhance the resilience of the European institutions and to improve the supervision of cross-border banking groups.

Refinancing, internal models and leverage ratio

In keeping with this objective, the Commission is putting forward a proposal for the introduction of an indicator for stable funding in accordance with its responsibility under Article 510(3) of the CRR. This is based on the Basel Committee's net stable funding ratio (NSFR), but currently still has some features that are different, in particular in relation to the treatment of derivatives.

In addition to this, as part of its revision of the CRR, the Commission is implementing the standard on determining the minimum capital requirements for market risk, which resulted from a fundamental review of the trading book rules by the Basel Committee. The standard lays down new rules for the approval of internal models and also puts forward a distinctly more risk-sensitive standardised approach, which is also suitable as a fallback solution for modelling applications that are turned down or withdrawn.

With respect to the leverage ratio, the Commission's draft envisages a mandatory Tier 1 capital requirement of 3 %. The text also includes adjustments to the exposure value, for example to bring the calculation of derivatives positions into line with the Basel rules. The Commission is also proposing to exclude certain exposures – such as loans to finance public-sector investments by public development banks, pass-through promotional loans and officially guaranteed export credits – from the calculation of the leverage ratio.

Large exposure rules, consolidation and banks from third countries

The main objective with respect to the large exposure rules is to implement the large exposure framework published by the BCBS in April 2014. A central feature is that Tier 2 capital will no longer be included in the determination of the upper limit for large exposures and in future only an institution's Tier 1 capital is intended to be used for this purpose.

Changes to the CRR and CRD IV are intended to ensure that financial holding companies and mixed financial holding companies come under closer supervisory control. In particular, it is proposed that in future they should require authorisation by the supervisory authorities.

Total loss-absorbing capacity

A further component of the reform package is the implementation of the global standard on total loss-absorbing capacity (TLAC). The total loss-absorbing capacity is made up of the Basel III own funds requirements and liabilities that are particularly suitable for conversion into equity. According to the Commission's proposal, it is intended to be incorporated into the minimum requirement for own funds and eligible liabilities (MREL) which already applies to all European banks.[2]

Reduced burden for smaller institutions

With regard to small, less complex banks, the Commission wants to reduce what it considers to be the disproportionate administrative burden caused by some of the rules on remuneration, for example the deferral of some components of remuneration and remuneration in the form of instruments such as shares. Furthermore, the CRD IV and CRR are supposed to take greater account of the proportionality

2 For further information on this subject, see 1.7.

principle in future in order to reduce the burden for these institutions.[3]

1.3 Amendments to the MaRisk

BaFin plans to publish a revised version of its Minimum requirements for risk management (MaRisk) in the second quarter of 2017. BaFin had submitted the draft for consultation on 18 February 2016.[4] The essentially principles-based character of the MaRisk has been retained. This enables BaFin to preserve its necessary scope for flexibility in implementing the requirements in practice.

One of the central reasons for revising the MaRisk was the transposition of BCBS 239, the BCBS principles for effective risk data aggregation and risk reporting, into German supervisory practice. BaFin and the Bundesbank saw a particular need for improvements in the provisions relating to the capabilities of IT systems. Other objectives of the amendments were to establish an appropriate risk culture and to expand and clarify the requirements for outsourcing.

Risk data aggregation

The new module AT 4.3.4 of the MaRisk implements the BCBS requirements for risk data aggregation, which are of a somewhat technical nature. The module is intended to help improve the IT infrastructure of larger and more complex institutions. It is intended to ensure that institutions aggregate their risks on an up-to-date and accurate basis using automated processes as far as possible.

The new module is specifically aimed at global systemically important and other systemically important institutions[5] within the meaning of sections 10f and 10g of the German Banking Act (*Kreditwesengesetz*). The objective is to provide decision-makers at these banks with important data and information concerning internal reporting, enabling them to respond immediately to changes in the institution's risk situation and its economic environment. This can only happen if the data are as complete, accurate and up-to-date as possible. The banks will need to expand their capabilities for risk data aggregation and redesign their IT systems, which is bound to require a considerable effort. However, this should result in a noticeable improvement in the quality of reporting.

In order to organise the requirements for risk reporting in a clearer manner, BaFin has brought the previously existing risk reporting requirements together in a new module BT 3 and added additional provisions on a selective basis. The module is directed at all institutions, but makes it clear that the way they implement it must be proportional.

Appropriate risk culture

The development, encouragement and integration of an appropriate risk culture within an institution, as now demanded by the revised module AT 3, goes beyond the previous MaRisk requirements for an appropriate risk management system. The objective of those requirements was to ensure that institutions remained strictly within the levels of risk acceptance defined by management. But an appropriate risk culture goes further. BaFin based the structure of the module on international initiatives such as the Financial Stability Board's guidance on supervisory interaction with financial institutions on risk culture dated 7 April 2014.[6] The real purpose is to promote conscious analysis of risk in the institutions' day-to-day business and to firmly anchor this risk assessment in their corporate culture. The aim is to create an awareness of risk at all levels of the institutions, which shapes the everyday thought and action of all employees and decision-makers. This is intended to build up a system of values that demands economically and ethically desirable behaviour and ensures that undertakings are successful in the long term. Among other

3 On the plans for the creation of a capital markets union which the EU Commission wants to push ahead with, see chapters I 2.1. and II 6.1.

4 www.bafin.de/dok/7871982 (only available in German).

5 See 1.7.

6 http://www.fsb.org/2014/04/140407/.

things, this requires a critical dialogue on risk-relevant topics to be initiated within an institution and encouraged by its management.

Outsourcing

Experience gained from supervisory practice and frequent questions relating to outsourcing prompted BaFin to clarify and add to the relevant requirements in module AT 9 of the MaRisk. The declared aim was to define the limits for outsourcing more clearly, especially in relation to risk control, compliance and internal audit.

It is now only possible to fully outsource the risk control function subject to strict preconditions. Only small institutions with very limited resources are permitted to outsource the compliance and internal audit functions, as further important control areas, in their entirety. However, it continues to be possible to outsource individual activities or processes in the control areas referred to. A new provision is that BaFin now requires a central outsourcing management system. Institutions with extensive outsourcing solutions, at least, will have to establish such systems in future. Other amendments clarify existing requirements such as those relating to sub-outsourcing, the distinction between outsourcing and external procurement or dealing with unforeseen terminations of outsourcing arrangements.

Entry into force

The new version of the MaRisk will come into effect upon its publication. Only the updated previous requirements must be implemented immediately, in order to allow the institutions sufficient time to adjust. The institutions have been granted one year for implementing the new requirements, and three years for the provisions of the new module AT 4.3.4 on risk data aggregation.

1.4 Remuneration Ordinance for Institutions

BaFin made the draft of the amended Remuneration Ordinance for Institutions (*Institutsvergütungsverordnung*), which it had worked on jointly with the Deutsche Bundesbank, available for public consultation in 2016. An oral hearing took place in November. BaFin plans to issue the amended version of the Remuneration Ordinance for Institutions in the second quarter of 2017. The ordinance will come into effect one day after publication.

The Federal Ministry of Finance had used a transfer order[7] to authorise BaFin to issue an amending ordinance. The principal objective of the amendment was to reflect the guidelines on sound remuneration policies[8] published by the European Banking Authority (EBA) on 21 December 2015.

The most important new features of the Remuneration Ordinance for Institutions are:

- All remuneration must be classified as fixed or variable. A third category of remuneration is no longer permitted.
- Allowances for staff working abroad or in a different position may qualify as fixed remuneration subject to certain conditions (including for the purposes of calculating the bonus cap pursuant to section 25a (5) of the Banking Act) and are therefore not subject to the risk adjustment provisions of the Remuneration Ordinance for Institutions.
- As an additional ex post risk adjustment instrument, significant institutions must have the following instruments for the purposes of complying with malus criteria:
  1. The ability to reduce retained bonus components.
  2. In addition, in cases of serious personal misconduct, the ability for a defined period to demand repayment of variable remuneration components already paid (clawback).
- Explicit rules govern the payment of a proportion of the variable remuneration in instruments eligible for bail-in – namely, as

7 Section 1 no. 5 of the German Regulation on the Transfer of Powers to issue Regulations to the Federal Financial Supervisory Authority (*Verordnung zur Übertragung von Befugnissen zum Erlass von Rechtsverordnungen auf die Bundesanstalt für Finanzdienstleistungsaufsicht*).

8 EBA Guidelines EBA/GL/2015/22.

part of the requirement in section 20 (5) of the Remuneration Ordinance for Institutions to link part of the remuneration paid to the subsequent performance of the institution. It is also made clear that, within the prudential scope of consolidation, the provisions of the ordinance also apply to the remuneration schemes of those employees whose professional activities materially affect the group's risk profile (group risk bearers).

The principle of proportionality continues to be implemented at institution and employee level in the form of thresholds (total assets and level of variable annual remuneration, respectively). Where those thresholds are reached or exceeded, the special requirements for the risk adjustment of the variable remuneration of risk bearers must be applied.

1.5 Accounting practice

The value of the assets and liabilities of a financial undertaking forms the basis for all solvency supervision. Financial supervisors' capital and liquidity requirements are based on prices and rates and their valuation by the accounting system. Over a long period of time, historical cost and market value proved to be reliable and verifiable bases for the valuation of an asset. In recent years of financial crisis, however, confidence in market values has been badly shaken. Markets collapsed or dried up. Others became so volatile that the current market price appeared to be random.

The consequence has been that today, instead of market value, the fair value based on assumptions and forecasts is determined for many financial products. Even in cases where a genuine market value can be determined in principle, the high cost of an exact valuation is sometimes an obstacle, for example in the case of valuing real estate as security in the lending business.

Accounting questions have traditionally played a major role in supervisory practice. BaFin collaborates in the interpretation of accounting rules, comments on proposed legislation and develops standards for the presentation and audit of financial statements. Where necessary, BaFin also adjudicates on appeals against rulings by the Financial Reporting Enforcement Panel (FREP) as the second stage of the enforcement process for accounting standards.

As a general rule, BaFin relies on the high quality of German accounting and auditing on the basis of the opinions and standards issued by the Institute of Public Auditors in Germany (*Institut der Wirtschaftsprüfer* – IDW) and the Accounting Standards Committee of Germany (*Deutsches Rechnungslegungs Standards Committee* – DRSC), and monitored by the FREP. For some time, BaFin itself has been looking at valuation standards and procedures more closely. It has therefore established a division concerned with questions of accounting practice, such as the scope for flexibility in making valuations and the options available to the undertakings. The objective is to form its own understanding of the processes involved in arriving at the values which form the basis for many fundamental indicators in financial supervision. BaFin has also authorised the division to carry out its own inspections for this purpose in particular cases.

1.6 Change in law on netting

On 9 June 2016, the Federal Court of Justice (*Bundesgerichtshof* – BGH) ruled[9] that settlement agreements between parties to share option transactions subject to German law are invalid to the extent that they conflict with section 104 of the German Insolvency Code (*Insolvenzordnung*). In such cases, section 104 of the Insolvency Code applies directly.

In reaction to the BGH's netting judgment, BaFin issued a general administrative act[10] based on section 4a of the German Securities Trading Act (*Wertpapierhandelsgesetz*) on

9 Judgement of 9 June 2016, case ref. IX ZR 314/14.

10 General Administrative Act to ensure legal certainty for netting agreements in the scope of German insolvency law (ref. no.: ED WA-Wp 1000-2016/0001) of 9 June 2016. Available at www.bafin.de/dok/7989284.

9 June 2016 (see info box "Netting"). This provided that netting agreements within the meaning of Article 295 of the Capital Requirements Regulation (CRR) should continue to be settled in accordance with the agreement. BaFin's intention was to remove the uncertainty that had arisen in the wake of the judgment relating to the recognition by the supervisory authorities of netting clauses in master agreements. This affected master agreements for financial derivatives transactions in particular. A further objective was to prevent the negative consequences that were threatening to affect the financial markets.

In response, the federal government put forward draft legislation[11] in September 2016, under which section 104 of the Insolvency Code was to be amended to allow netting clauses that continue to apply in the event of insolvency to be agreed once again. Such clauses would also comply fully with the requirements for recognition for supervisory purposes, for example pursuant to Article 296(2a) and Article 178 of the CRR. The amending law, which came into force retrospectively in some respects, was promulgated in the Federal Law Gazette on 28 December 2016.[12]

1.7 Recovery and restructuring

BaFin uses the term "restructuring" to encompass a number of initiatives with similar objectives that were introduced as a consequence of the financial crisis in 2007/2008. An important element of this is recovery planning, aimed at further improving the institutions' resilience. A new Regulation issued by the Federal Ministry of Finance contains Minimum requirements for the contents of recovery plans (*Mindestanforderungen an die Ausgestaltung von Sanierungsplänen*), which implement and/or add to the provisions of the German Recovery and Resolution Act (*Sanierungs- und Abwicklungsgesetz*) and of the European Banking Authority.

Netting

Netting refers to two business partners offsetting their claims against each other in order to reduce counterparty risk. In such circumstances, the institution is required to maintain capital backing only for the net amount due, provided that the contractual arrangements comply with the requirements of Article 295 et seq. of the CRR. Where that is not the case, the institution is required to treat the amounts due as separate transactions. This could result in significantly higher capital requirements – depending on the institution and the portfolio.

Additional focal points for BaFin during the year under review were the identification of financial institutions posing a potential systemic risk (*potenziell systemgefährdende Institute* – PSIs), the stipulation of higher capital requirements for global and national systemically important institutions and the implementation of the German Ringfencing Act (*Abschirmungsgesetz*).[13] In addition, the EU Commission drafted provisions in 2016 specifically addressing the recovery and resolution planning of central counterparties (CCPs).

Recovery and resolution regime for CCPs

In 2012, European legislators introduced the European Market Infrastructure Regulation (EMIR), which requires standardised over-the-counter (OTC) derivatives transactions to be cleared through CCPs. Since these derivatives are now no longer cleared between banks, the risks of contagion in the event of a bank defaulting are reduced. This measure has made financial markets significantly more robust. At the same time, however, market participants' dependence on the CCPs has risen substantially, which entails higher risks for the stability of the financial markets in the event of default by a CCP.

11 Government draft of a Third Act Amending the Insolvency Code, Bundesrat printed paper 548/16 = Bundestag printed paper 18/9983.

12 Act Amending the Insolvency Code and Amending the Act Introducing the Code of Civil Procedure dated 22 December 2016, Federal Law Gazette I, page 3147.

13 Federal Law Gazette I 2013, page 3090.

In order to counter those risks, a recovery and resolution regime is required that at least ensures that the functions of CCPs that are critical for the financial markets are protected. The existing recovery and resolution regime of the BRRD – implemented in Germany mainly by the Recovery and Resolution Act – is in the first place only applicable to CCPs that are at the same time CRR credit institutions.[14] In the second place, the Recovery and Resolution Act is designed for banks and is therefore not adapted to counter the specific risks arising from the business model of the CCPs. In particular, the resolution mechanisms set out in the Recovery and Resolution Act, such as writing down liabilities in consideration for the issue of shares (bail-in), are not sufficiently effective for CCPs.

Against this background, the EU Commission has developed rules for the recovery and resolution of CCPs. These were published in November 2016 as a draft regulation. The draft contains provisions enabling open positions to be closed and default losses arising from the default of clearing members, generally banks, to be settled. The draft is also intended to regulate the treatment of losses arising from the operating business of the CCPs themselves (non-default losses). The latter include losses from IT disruptions or errors in managing the collateral clearing members have to provide.

MaSan Regulation

The Recovery and Resolution Act imposes an obligation on all institutions to prepare a recovery plan. Prior to the entry into force of the Recovery and Resolution Act, this was only mandatory for PSIs. In addition to the Recovery and Resolution Act, requirements for the contents of recovery plans are derived from the EBA guidelines on recovery plan scenarios and indicators and Commission Delegated Regulation (EU) No 2016/1075. Furthermore, the Federal Ministry of Finance is authorised pursuant to section 21a (1) of the Recovery and Resolution Act to set out minimum requirements for the contents of recovery plans in a Regulation (MaSan Regulation).

The Federal Ministry of Finance will conduct a public consultation exercise on the draft Regulation beforehand. The Regulation deals with the recovery plans of the PSIs. The latter must satisfy all of the requirements at all times in view of their nature as institutions posing a potential systemic risk. The MaSan Regulation also stipulates simplified requirements for the recovery plans which non-PSIs are required to prepare. In addition, the MaSan Regulation specifies requirements for the recovery plans of institutional protection schemes (IPSs). The background to this is the possibility of exempting institutions from the obligation to prepare a recovery plan, if they belong to an institutional protection scheme and are not considered to pose a potential systemic risk. In this event, the IPS must prepare a recovery plan relating to the institutions exempted. Accordingly, the MaSan Regulation sets out the rules for the application for exemption, the necessary preconditions and the requirements for the contents of such recovery plans.

Guidance Notice on recovery planning

In addition, BaFin and the Deutsche Bundesbank are planning to publish a Guidance Notice on recovery planning. Prior to its issue, BaFin and the Bundesbank will launch a public consultation on the Guidance Notice. This is intended to take place at the same time as the public consultation on the MaSan Regulation. The Guidance Notice on recovery planning explains the provisions of Delegated Regulation (EU) No 2016/1075 and is intended to illustrate the interaction of the MaSan Regulation with Delegated Regulation (EU) No 2016/1075.

Systemically important institutions and institutions posing a potential systemic risk

BaFin reviews the classification of institutions as posing a potential systemic risk at least once a year in consultation with the Deutsche Bundesbank. An institution poses a potential systemic risk if it is either a

14 Credit institutions which satisfy the criteria in Article 4(1)(1) of the CRR.

global systemically important institution (G-SII) or another systemically important institution (O-SII), or if BaFin is unable to allow this institution to apply the simplified requirements for recovery planning (see info box "Institutions posing a potential systemic risk in 2016" on page 91).

Interpretive guidance on the Ringfencing Act

BaFin has developed interpretive guidance on the Ringfencing Act dated 7 August 2013 jointly with the Bundesbank. It references Article 2 of the Act. The Act prohibits deposit-taking credit institutions above a specified size from engaging in proprietary business. Lending and guarantee business with hedge funds and alternative investment funds (AIFs) is also not permitted. The prohibition also applies to high-frequency trading with the exception of market-making activities within the meaning of the EU Short Selling Regulation.[15] For example, if a proprietary trader provides liquidity to the market on a regular and ongoing basis by posting firm, simultaneous two-way quotes for financial instruments, this market-making activity is excluded from the scope of the activities prohibited.

The interpretive guidance provides the credit institutions with guidelines on the provisions of the Ringfencing Act and so contributes to greater legal certainty on the implementation of the statutory requirements.

The interpretive guidelines make clear, for example, the extent of the prohibition on conducting proprietary business and the distinction from proprietary trading. They also explain the meaning of lending and guarantee business and the cases in which even indirect lending and guarantee business is prohibited. In addition, the interpretive guidance deals with the determination of the leverage of an AIF, which is relevant for the scope of the prohibited activities.

15 Regulation (EU) No 236/2012 of the European Parliament and of the Council of 14 March 2012 on short selling and certain aspects of credit default swaps (OJ EU 86 dated 24 March 2012, page 1).

Implementation of the TLAC and MREL requirements

On 9 November 2015, the FSB published the global standard on total loss-absorbing capacity (TLAC).[16] This also entailed an obligation on the part of the FSB member states to implement the standard in their national legal systems. The member states of the European Union implement the standard at EU level. For this purpose, on 23 November 2016, the EU Commission published proposed legislation as part of its reform package[17], with the objective of amending various directives and regulations – including the CRR and the BRRD. The EU Commission's proposed legislation also includes changes to the provisions on the minimum requirement for own funds and eligible liabilities (MREL)[18] and integrates the MREL and TLAC into a single concept. BaFin was represented in the group of experts which advised the EU Commission on the drafting of the proposed legislation.

TLAC Standard

From 2019 onwards, the standard on total loss-absorbing capacity requires own funds and eligible liabilities equal to at least 16 % of risk-weighted assets and 6 % of the leverage exposure. These requirements will rise to 18 % and 6.75 %, respectively, at the start of 2022.

Under the proposed legislation, the minimum requirements for total loss-absorbing capacity in the form of liabilities and own funds prescribed by the TLAC Standard would now also become a statutory minimum for the MREL. To date, the resolution authority has set the MREL ratio individually for each institution depending on its business model, risk profile and resolution strategy. Under the Commission's proposal, the MREL can still be specified individually for global systemically important institutions, but it may not be less than the minimum prescribed by the TLAC.

16 See 2015 Annual Report, pages 109 ff.

17 On the reform package, see 1.2.

18 See 2015 Annual Report, pages 109 ff.

Institutions posing a potential systemic risk

In 2016, BaFin classified a total of 39 institutions as institutions posing a potential systemic risk (PSIs). The 39 institutions included 1 global systemically important institution (G-SII) and 14 other systemically important institutions (O-SIIs). The number of PSIs rose slightly from 37 institutions to 39 compared with the previous year. While the number of G-SIIs remained unchanged, the number of O-SIIs declined from 16 institutions to 14. This was due firstly to the merger of two O-SIIs and secondly to one institution being assessed as having lower systemic importance during the annual review. By contrast, the number of institutions which BaFin did not permit to apply the simplified requirements for recovery planning increased by 4 institutions compared with the previous year. They include 1 institution for which it was not possible to determine whether it qualified as a PSI in 2015. They also include 2 institutions that were not classified as PSIs in 2015. The reason for this is that the assessment method was revised and four indicators used by the scoring model for the quantitative analysis were changed. In keeping with the EBA guidelines on the assessment of O-SIIs, the method therefore now also records receivables from and liabilities to foreign central banks as part of receivables from and liabilities to foreign banks. Moreover, the number of legally independent domestic and foreign subsidiaries, used as an indicator, now includes only the legally independent domestic and foreign institutions of the superordinate entity for supervisory purposes, and no longer includes downstream financial undertakings as well.

The rules for setting the MREL for individual institutions will still be contained in the BRRD and/or the Single Resolution Mechanism (SRM) Regulation after the reform. But in order to create a uniform framework for Pillar I own funds and eligible liabilities requirements, the provisions relating to the statutory minimum (TLAC) will be set out in the CRR. The EU Commission's proposed legislation therefore prescribes corresponding amendments to the CRR. There remain differences of opinion between the member states on a number of points contained in the proposal, and these will need to be resolved in the further course of the legislative process.

Also in relation to the MREL, BaFin has published a liability cascade for the event of a bail-in.[19] The MREL is highly significant for the effective implementation of a bail-in, since the latter involves writing down liabilities and converting them into equity in the event of a resolution. This enables losses to be covered and the institution to be provided with fresh capital, without the need to use taxpayers' funds for this purpose. In this process, the MREL ensures that sufficient suitable liabilities are in fact available. The critical factor for the resolution is then the order in which owners and creditors are liable and in which liabilities are written down or converted. This order is laid down by the liability cascade published by BaFin.

1.8 Sovereign exposures

Loans to states, local government and public-sector bodies (sovereign exposures) in the banking book have become a focal point for regulation due mainly to the sovereign debt crisis and the zero risk-weighting of eurozone countries. The objective both in the Basel Committee and at EU level was to develop appropriate regulatory policy options to loosen the nexus between sovereign borrowers and banks. The topic is now highly sensitive because a revision of the risk weightings has come to form part of the discussions on completing the banking union. In order to avoid duplication of work, the EU is initially waiting for the outcome of the discussions in the Basel Committee. These are expected to need more time. Due to the high degree of political significance, the work is planned to proceed in a careful, gradual

19 See Overview of the liability cascade in bank resolution (as at 1 January 2017), available at www.bafin.de/dok/8962124.

and holistic manner. A further reason for the length of the negotiations is the wide range of different interests still represented in the relevant bodies. It is correspondingly difficult to reach compromises.

A consultation or discussion paper setting out possible courses of action is planned for 2017. The options for discussion are as follows:

- Inclusion of credit risk, involving the introduction of a lower limit for risk weighting and therefore the setting of risk-sensitive capital requirements
- Inclusion of concentration risk using marginal risk-weighting premiums dependent on the ratio of the exposure value to eligible own funds
- Improvements in Pillars II and III of the Basel framework, in particular the inclusion of sovereign risk by means of stress tests and increased disclosure of sovereign exposures
- Alternatively: retention of the status quo

Closely linked to the development of these options is a tighter definition of the state as a borrower unit and the associated risk weighting premiums. This is intended to prevent regulatory arbitrage. The consultation paper therefore also expresses an opinion on this issue and sets out possible solutions.

The draft consultation paper must first be submitted to the Group of Governors and Heads of Supervision (GHOS) in accordance with the mandate. The GHOS will also decide whether the draft will be published as a consultation paper or as a discussion paper.

2 Supervision in practice

2.1 Discussion topic: the SREP in Germany

2.1.1 SREP capital requirements in 2016

In 2016, based on the national implementation of the EBA Guidelines on common procedures and methodologies for the supervisory review and evaluation process (SREP)[20], BaFin began the process of determining a capital add-on for less significant institutions (LSIs).[21] This capital requirement – as an addition to the minimum capital requirements under Pillar I of the regulatory framework for banks – relates to those risks that Pillar I (8 % of risk-weighted assets) covers only inadequately or not at all. The Pillar I requirement is therefore supplemented by an additional capital requirement: Pillar I "plus". It must be complied with just as rigorously as the 8 % requirement under Pillar I.

Interest rate risk in the banking book

For the majority of the institutions supervised by BaFin, the most significant risk that is not covered by Pillar I is interest rate risk in the banking book. It is mainly, though not exclusively, determined by the institutions' maturity transformation activities. But there are other risks not found in Pillar I which the banks themselves consider to be material,

20 EBA/GL/2014/13 Guidelines on common procedures and methodologies for the supervisory review and evaluation process (SREP).

21 The capital requirement for significant institutions (SIs) is set by the ECB.

such as funding risk. However, insolvency risk as a component of liquidity risk is not taken into account in this context since it essentially cannot be backed with capital.

In practice, the institutions had to quantify the additional risks even before the introduction of Pillar I "plus" and back them with capital for risk cover. But this took place in the context of an internal procedure, namely the risk-bearing capacity concept as the German equivalent of the Internal Capital Adequacy Assessment Process (ICAAP). The ICAAP and its future-oriented supplement in the form of capital planning constitute the risk-bearing capacity approach, which BaFin had already scrutinised and assessed in the past but which did not lead to a specific regulatory capital requirement.

The new Pillar I "plus" represents a different approach. The ICAAP remains the starting point for the risk assessment, but BaFin is now required to use this as a basis to set a capital requirement itself and communicate the binding result to the institutions. Only regulatory capital recognised under Pillar I (i. e. Common Equity Tier 1 capital, Tier 1 capital and Tier 2 capital) can be used as risk cover, internal components of capital (e.g. expected profits) cannot be used. The minimum ratio for the mix of types of capital under Pillar I (at least 56 % Common Equity Tier 1 capital and at least 75 % Tier 1 capital) also applies.

The principal feature of the EBA approach described above is that the calculation of the capital requirement is based on the type of risk, with the exclusion of diversification effects across different types of risk. For the Pillar I risks (credit risk, market risk and operational risk), the CRR capital requirements are compared with the results of the ICAAP and in each case the higher value is used, i. e. at least 8 % for the three types of risk. If an institution identifies other material risks in addition to the Pillar I risks, then the resulting capital requirement must be higher than 8 %. For this reason, the "plus" really is a plus – only in exceptional cases is an institution likely to have no risks other than those under Pillar I.

Specific considerations for Germany

The great challenge for German supervisors in 2016 was to develop a method of calculating the capital requirement that reflected the particular nature and structure of the German banking sector: starting from the existing qualitative assessment, the objective was to derive risk-oriented capital requirements for a large number of institutions. Here, BaFin benefitted from the principle of proportionality incorporated in the EBA guidelines. This means that it has to notify a capital requirement for less significant institutions only once every three years. This applies for at least as long as their risk situation remains unchanged. BaFin therefore identified an initial 319 institutions in 2016 that were to be the first to receive capital requirements notices.

ICAAP as a basis

In principle, the information from the ICAAP serves as the basis for the quantification of risk. As at 31 December 2015, the institutions were required to submit notifications in accordance with the German Financial and Internal Capital Adequacy Information Regulation (*Verordnung zur Einreichung von Finanz- und Risikotragfähigkeitsinformationen*) for the first time. The quantification of the other material risks in addition to the Pillar I risks is based directly on these notifications by the institutions. With respect to the interest rate risk in the banking book, however, BaFin carries out its own quantification. Based on the results of the interest rate shock (a parallel shift of 200 basis points in the yield curve) familiar from the Basel framework, it includes only half of the negative change in present value. The quality of the risk management system is taken into account, both for the risks taken from the ICAAP and for the interest rate risk in the banking book. A good sub-rating from the risk profile for the respective risk will generally have the effect of reducing the capital requirement, while a poor rating may increase the capital requirement.

Average SREP overall capital requirement of 9.49 %

In 2016, BaFin notified 303 of the total of 319 institutions examined of their capital requirement. On average, the institutions were required to maintain 0.89 percentage points for interest rate risks and 0.59 percentage points for other material risks in addition to the Pillar I requirement. The resulting average SREP overall capital requirement for all of the institutions examined by BaFin in 2016 for the purpose of setting a capital requirement amounted to 9.49 %, which was higher or lower in individual cases depending on the institution and the nature of the risks (see Figure 1 "2016 SREP overall capital requirement").

Institutions that were not notified of their capital requirement by BaFin in 2016 are required as from 1 January 2017 to cover at least the interest rate risk quantified by BaFin on the basis of the interest rate shock. The legal basis for this is a general administrative act dated 23 December 2016, which is intended to ensure equal treatment of the institutions for this material type of risk at least with respect to the approach adopted. If one of these institutions receives a SREP overall capital requirement notice which becomes effective, the general administrative act ceases to apply to that institution.

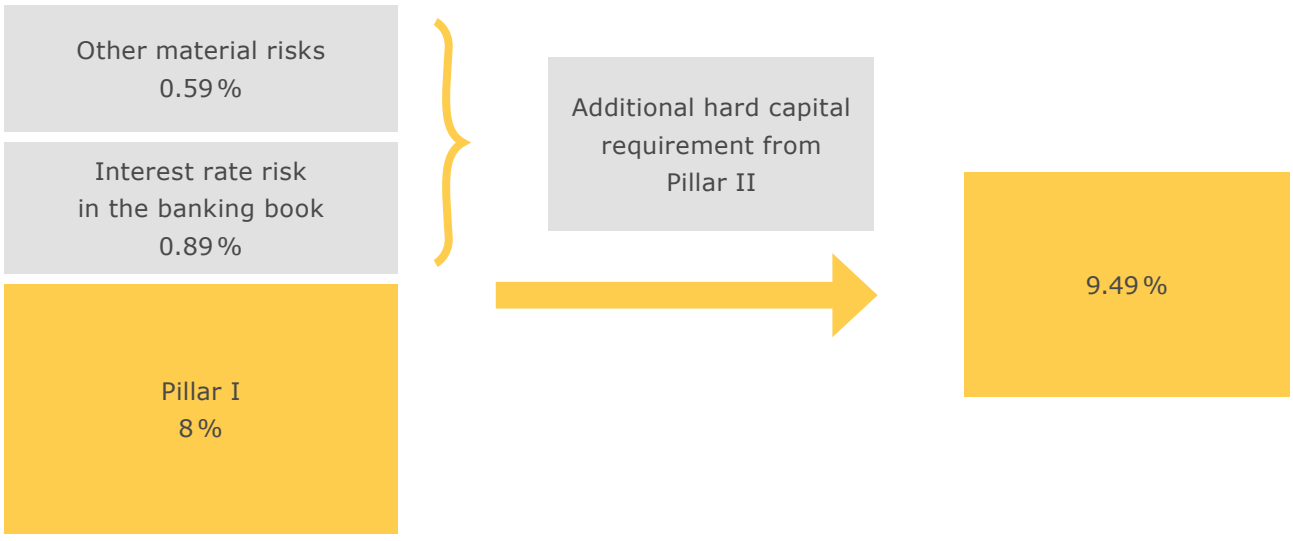
The combined buffer requirement pursuant to section 10i of the German Banking Act (*Kreditwesengesetz*) must be complied with in addition to the SREP overall capital requirement. However, for the large majority of institutions only the capital conservation buffer pursuant to section 10c of the Banking Act is currently significant.

Target own funds indicator

A similar role to the capital conservation buffer is played by the target own funds indicator which BaFin notified to the institutions for the first time in 2016. It relates to the coverage of risks emerging in periods of stress. BaFin uses the target own funds indicator to notify the institutions about how much additional capital they should maintain from a supervisory point of view in order to ensure that they are able to comply with the SREP overall capital requirement over the long term and after taking into account potential losses in stress phases. BaFin used the findings of its 2015 survey on the low interest rate environment[22] as the basis for quantifying the target indicator. Offsetting against the capital conservation buffer is permitted. The institutions may cover the amount of the target own funds indicator in excess of this buffer either with regulatory capital or with free reserves pursuant to

22 www.bafin.de/dok/8216350 (only available in German).

Figure 1 2016 SREP overall capital requirement



section 340f of the German Commercial Code (*Handelsgesetzbuch*). On the other hand, the capital conservation buffer must always be covered by Common Equity Tier 1 capital.

In general, the target own funds indicator is more of a target or guidance figure: in contrast to the regulatory capital requirements, it does not represent a minimum figure which must be complied with to avoid immediate supervisory measures.

The average target own funds indicator for the 319 institutions examined in 2016 amounted to 1.35 %. The target own funds indicator may be offset against the capital conservation buffer (2016: 0.625 %; 2017: 1.25 %).

2.1.2 Opinion

Raimund Röseler on the German SREP

Minimum requirements vs. the complete picture

Credit risk, market risk and operational risk: these are the three types of risk defined by the Basel Committee on Banking Supervision for a global standard minimum capital requirement of eight percent. However, it is not possible to fit every banking transaction in the world into a model of three types of risk, nor can a single minimum capital requirement adequately reflect the risk characteristics of every individual institution. Such a requirement is precisely what it claims to be: a minimum requirement.

More than 10 years ago, in order to enable supervisors to set institution-specific requirements for all material risks, the Basel Committee created Pillar II as part of Basel II[23] to supplement the minimum capital requirements, which from that time on formed Pillar I of its regulatory framework. This second Pillar is intended to capture all of an institution's risks, including those not addressed by the Pillar I minimum capital requirements. It has also been incorporated into the Banking Act via Brussels.

Raimund Röseler

is Chief Executive Director of Banking Supervision.

Pillar I "plus" approach

The cornerstone of Pillar II is the Supervisory Review and Evaluation Process (SREP). While Basel grants supervisors considerable freedom in the choice of supervisory approach for the SREP, in Europe the complete harmonisation of Pillar I by the CRR (Capital Requirements Regulation) has now been followed by the harmonisation of the Pillar II supervisory process on the basis of the guidelines published by the EBA. The Pillar I "plus" approach, which has been applied in the United Kingdom for some time now, has prevailed. It involves supplementing the minimum requirement with an institution-specific regulatory capital requirement, aimed at covering those risks captured only partially or not at all by Pillar I.

23 Basel II was published in June 2004 and came into effect at the end of 2006. The European Union (EU) implemented the regulatory framework in June 2006 in the form of the Banking Directive (2006/48/EC) and the Capital Adequacy Directive (2006/49/EC). Basel III was published at the end of 2010. It also encompasses Basel II and the further amendments published subsequently by the Basel Committee. Basel III was implemented in the EU by the Capital Requirements Directive IV (CRD IV) and the Capital Requirements Regulation (CRR).

The new regulatory capital requirement is made up of both elements – the regulatory minimum capital requirement under Pillar I and the institution-specific capital requirement for risks not addressed by Pillar I.

Risk-based test run

In 2016, BaFin implemented capital requirements on the basis of the SREP for an initial 319 institutions, in what could be called a risk-based test run, to enable it to dedicate the necessary care and attention to each of the total of approximately 1,600 institutions under its direct supervision. The remaining institutions were required to maintain sufficient capital to cover interest rate risks in the banking book in addition to the Pillar I minimum requirements, on the basis of a general administrative act issued by BaFin in December 2016[24] (see info box "General administrative act", page 97). Further institutions will undergo BaFin's procedure for setting a capital requirement during 2017. The general administrative act will cease to apply when their SREP notices become legally effective. BaFin's objective is to notify all institutions of their individual regulatory capital requirements as quickly as possible. The experience gained in the first run will form a solid foundation for future procedures and gradually both BaFin and the institutions will be able to develop this into a routine.

Risk-orientation and transparency

BaFin's approach to setting capital requirements has two guiding principles: risk-orientation and transparency. Risk-orientation calls for a capital requirement which is appropriate to the individual risk, and which takes into consideration the institution's own risk quantification as well as BaFin's assessment. BaFin used the institutions' calculations of risk-bearing capacity for this purpose, which meant that no additional data had to be provided in order to set the SREP capital requirement; it was based solely on data already available.

A point that was and continues to be important for BaFin is that the way in which capital requirements are set should not be a secret. To this end, BaFin presented its methodology in numerous discussions with the institutions and at a major public event in May 2016. In 2016, BaFin commenced the process of setting a capital add-on in the SREP for all of the approximately 1,600 institutions under its direct supervision[25]. In its notices of hearing to the institutions, it explained the calculation of their individual SREP capital requirements, and gave them the opportunity to review their capital requirements themselves and raise queries about them in exchanges with BaFin.

Balanced approach

BaFin firmly believes that its SREP represents a balanced approach which stands up well to international comparison.

A certain robustness in setting the capital requirement benefits both BaFin and the institutions, because there is no need to adjust the SREP capital add-on for every minor change in risk. The capital requirement is therefore set in incremental steps and does not conform to a linear distribution. Where there are only insignificant changes in the institution's level of risk, in most cases no amendment to the SREP notice is necessary. The capital requirements for the individual steps (which are also called "buckets") are based on the capital requirement for the lower threshold of the bucket. However, if there is a material and sustained change, whether positive or negative, in an institution's risk position, BaFin will initiate a new SREP – if necessary independently of the three-year cycle which normally applies for smaller institutions.

No replacement for qualitative supervision

The expansion of the capital requirement to include an institution-specific requirement does not replace the existing qualitative supervisory approach under Pillar II, but rather adds a quantitative component, yet a very important one, to it. BaFin will, of course, continue to monitor the institutions' proper management and their internal assessments of risk-bearing capacity. But it remains to be seen what

24 www.bafin.de/dok/8714828 (only available in German).

25 These are the less significant institutions (LSIs).

General administrative act

On 23 December 2016, BaFin issued a general administrative act aimed at all institutions falling within the scope of the circular on interest rate risks in the banking book. Under this general administrative act, the institutions under BaFin's direct supervision are obliged to maintain capital backing for interest rate risks in addition to the capital requirements stipulated in the Capital Requirements Regulation (CRR). It did not apply to institutions which had already received a notice in the context of the Supervisory Review and Evaluation Process (SREP) that was final or, in the event of an objection, immediately enforceable by the date of the act. For all other institutions concerned, the general administrative act ceases to have effect as soon as an institution has received a final or, in the event of an objection, immediately enforceable SREP notice. The interest rate risk was calculated on the basis of the Basel interest rate shock described in BaFin Circular 11/2011. Accordingly, the general administrative act normally applies to individual institutions and not to groups.

reciprocal effects will emerge between the regulatory SREP capital requirement procedure and the Internal Capital Adequacy Assessment Process. In the ICAAP, the institutions are expected to identify their material types of risk, assess them using their own methods and back them with sufficient capital. Moreover, that capital must also be qualitatively capable of absorbing any losses that occur. What is certain is that supervisory guidance on the evaluation of the institutions' internal risk-bearing capacity concepts will have to be revised, and to achieve this BaFin also aims to work closely with the banking industry. Initial discussions on this subject have already taken place and BaFin will push ahead with the topic in 2017, with the goal of completing the necessary amendment to the guidance as soon as possible.

Strengthening the institutions' resilience

The low interest rate environment, which has already lasted for an unusually long time, continues to create challenges for the banks. Pressure on earnings will intensify further if interest rates do not change in the foreseeable future and remain stuck at historic lows for an even longer period. In its survey on the low interest rate environment in 2015, BaFin simulated a shock scenario that demonstrated possible effects on the institutions' earnings situation. This type of stress test helps BaFin gain a more future-oriented perspective on the robustness of the German banking system, and it will make use of this tool whenever necessary.

The results of the survey on the low interest rate environment are also incorporated into the SREP. However, unlike interest rate risk, they are not reflected in the actual SREP capital requirement but in a target own funds indicator. This functions as a kind of individualised capital conservation buffer and can be offset in the SREP against the capital conservation buffer pursuant to section 10c of the Banking Act, which acts as the minimum level. This is intended to strengthen the institutions' resilience in difficult periods as well.

Further harmonisation of the SREP by the ECB

The EBA's SREP guidelines have harmonised the supervisory process in Europe and have laid down a uniform procedure for determining the additional capital requirement for Pillar II risks. The Single Supervisory Mechanism (SSM), which harmonises the supervision of the largest institutions in the 18 eurozone countries, provides further details of its implementation in practice. While supervision of the most important banks[26] has been carried out directly by the SSM since 2014, in future the intention is for common supervisory standards to be applied in the supervision of the less significant institutions by national supervisory authorities as well. BaFin is playing a part in efforts to further harmonise regulation and supervision in the EBA and SSM. One of its objectives is to preserve the core elements of approaches that

26 Significant institutions (SIs).

have proven effective in Germany for many years while at the same time guaranteeing high standards of European supervision. To achieve this, BaFin sometimes has to use its powers of persuasion; at other times, however, it must practise the art of balancing different supervisory objectives, but also, in particular, different supervisory cultures within Europe.

2.1.3 Low interest rate environment

In view of the current low interest rate environment and the associated impact on the institutions' earnings, the Bundesbank and BaFin will conduct another survey on the low interest rate environment in 2017. The most recent similar survey from 2015 provided BaFin and the Bundesbank with important information about the earnings capacity and resilience of German institutions. BaFin would like to use the new version of the survey to find out more from the institutions about the performance of various earnings indicators assuming a number of interest rate scenarios.

The survey will also include a stress test covering credit risk, market risk and interest rate risk. With regard to credit risk, the intention is to analyse the institutions' resilience in the event of a deterioration in credit quality and a simultaneous decline in the value of collateral. For market risk, ratings-based increases in credit spreads and negative movements in price for a variety of asset classes are assumed. As far as interest rate risk is concerned, the effect of the Basel standard interest rate shock (a parallel shift of 200 basis points in the yield curve) on different indicators in the institutions' profit and loss accounts will also be assessed.

In principle, BaFin will include all of the institutions under its direct supervision in the survey. However, individual groups of specialist institutions – for example *Bausparkassen* – will carry out their own stress tests. This will enable BaFin and the Bundesbank to take adequate account of the particular characteristics of the institutions' specific business activities.

The results of the stress tests will be fed back into the target own funds indicator described above. In addition, from the survey it will also be possible to identify negative developments in earnings that are not incorporated directly in the target own funds indicator.

2.1.4 Business models

A central component of a bank's risk profile is the analysis of its business model. The latter's viability and sustainability represent focal points for BaFin. It also monitors whether there are indications that the bank is switching to niche strategies and whether it has taken adequate account of potential changes in the market environment and technological developments in its business and risk strategies. For the purposes of its assessment, BaFin makes particular use of the audit report evaluation, the institution's documentation such as strategic and capital planning, knowledge gained from supervisory interviews and special audits and information from the supervisory reporting system.

When analysing the business model, BaFin concentrates on how income arises and whether it can continue to be generated over the long term. It analyses whether current earnings can remain stable in the future – despite potential structural changes, fierce competition and increasing digitalisation – and how the institutions may need to modify their business models. Risks to earnings are a highly significant topic for the institutions not just because of the persistent low level of interest rates: in reality the level of competition and pressure on costs are increasing as well.

Bases for the analysis

In addition to section 25a of the Banking Act, the bases for the analysis include the EBA's guidelines on the SREP referred to above. The latter contain requirements relating to the key aspects of a comprehensive SREP. BaFin integrated the guidelines into its supervisory processes and procedures in 2016 and aligned its existing procedures for the development of institution-specific risk profiles with the EBA requirements. The business model has come to represent a more important element of an institution's overall risk profile. The findings have resulted in the first reviews of business models by the Deutsche Bundesbank.

2.2 Supervision of conduct

2.2.1 Code of conduct as a guiding principle

The image problem that the financial sector has had to struggle with since the start of the financial crisis has not gone away. According to a survey by the business consultants EY during the past year, more than one in three bank customers in Germany (37 %) reported that their confidence in the banking industry had fallen in the previous 12 months.[27] The reasons for this are likely to include the activities of some banks which have come to public attention in the past that were questionable, at the least from a moral point of view. Cum/ex trades and the use of letterbox companies, as in the Panama Papers case, are noteworthy examples. These examples also demonstrate the importance of the supervision of conduct alongside prudential supervision. The aims of the supervision of conduct include ensuring that the risk behaviour of employees and managers conforms to the bank's ethical principles.

Border between legality and legitimacy

Banks frequently operate in the border zone between legality and legitimacy. Not everything which is legal is also legitimate. The cases in the contributions below make it clear that even behaviour which may be (just about) legal can involve substantial reputational and legal risks. Misconduct destroys confidence, while fair and responsible behaviour creates confidence – independently of the question of legality. In order to restore confidence in the risk-aware and responsible behaviour of bank employees, BaFin has included an appropriate risk culture as a requirement for an appropriate risk management system in the amended MaRisk.[28] The objective of this requirement is to ensure that banks – or rather: the management boards and senior management levels of banks – make clear to their employees which types of conduct are desirable and which are undesirable, so that they can conduct themselves accordingly and minimise risks.

A code of conduct, as in future required by AT 5 of the MaRisk, is a sensible and helpful tool for this purpose as a moral compass. This is because if people are reminded of their moral compass, they will also behave accordingly, as the experiment conducted by a behavioural economist has shown.[29] A code of conduct allows senior managers to set out clear rules of the game for themselves and their employees, although they must accept that they will also be judged by those rules themselves. BaFin will do so rigorously.

For the banks, legitimate behaviour ultimately pays off in economic terms as well. Not only

27 EY Global Consumer Banking Survey 2016, 17 October 2016.

28 See 1.3.

29 *"Wie Trump das moralische Fundament der USA beschädigt"* (How Trump is damaging the moral foundation of the US) in Süddeutsche Zeitung, 8 December 2016.

do they achieve a substantial reduction in their legal and reputational risks, they can win back their customers' confidence, which is after all essential for a customer relationship to be successful in the long term.

2.2.2 Investigations into cum/ex trades

On 19 February 2016, the Bundestag appointed a parliamentary committee of inquiry with the objective, among other things, of clarifying the practice of German banks relating to cum/ex transactions in the period from 1999 to 2012 (see info box). In particular, the committee is charged with investigating the reasons for these cum/ex trades and how they evolved over time. It is also intended to clarify whether federal government bodies took measures in good time to counteract transactions of this type. The committee of inquiry has issued five requests for evidence requiring BaFin to submit documentation.

BaFin assisted the committee of inquiry with written submissions and BaFin employees were available to the committee to answer questions and provide additional details in keeping with BaFin's obligations. Raimund Röseler, Chief Executive Director of Banking Supervision, and Elisabeth Roegele, Chief Executive Director of Securities Supervision/Asset Management, also testified before the committee.

New legal situation since November 2015

The investigation of tax planning structures or tax offences does not fall within BaFin's immediate areas of responsibility. Until November 2015, the duty of confidentiality of BaFin employees with respect to the tax authorities set out in section 9 of the Banking Act was relieved only in the case of tax offences where there was a pressing public interest to prosecute. In the absence of a legal basis, however, this did not cover cum/ex transactions. With the adoption of the German Resolution Mechanism Act (*Abwicklungsmechanismusgesetz*), the wording of section 9 (5) of the Banking Act was amended to the effect that BaFin employees are relieved of their duty of confidentiality with respect to the tax authorities, if they have information which the latter require for proceedings relating to a tax offence and the associated tax assessment proceedings.

Cum/ex trades

Cum/ex trades used short sales around the dividend record date to create a situation in which, from a legal perspective, a share appeared to have more than one owner for a short period of time. The principal objective of transactions constructed in this way was to enable withholding tax on income from capital to be reimbursed or credited on more than one occasion, even though the tax had only been paid once. Following a change in the law in 2012, transactions of this kind are no longer possible in Germany.

In cases where there is involvement in tax evasion transactions, however, BaFin examines whether this has implications for the personal reliability of an institution's senior managers, independently of the prosecution of such activities by the tax authorities. It also reviews the effects of any additional payments of tax or fines on the relevant institution's solvency and liquidity position.

Following the publication of the Panama Papers, for example, BaFin also required the German credit institutions mentioned in them to hand over documentation. It used the latter to investigate whether the institutions had demonstrated the care required throughout their groups in identifying their customers and complying with the other provisions of anti-money laundering legislation.[30]

2.2.3 Investigations into the Panama Papers

In response to the Panama Papers case, BaFin tightened its controls in 2016 with the aim of identifying possible criminal transactions using letterbox companies. According to

30 See 2.2.3.

an international research association of journalists, more than 500 banks together with their subsidiaries and branches registered approximately 15,600 letterbox companies using the Panamanian legal firm Mossack Fonseca. This firm specialises in setting up offshore companies. 14 German banks also made use of letterbox companies in Panama, according to the Panama Papers.

In the past, BaFin appointed auditors to carry out controls of this nature and sent them into the banks to examine the papers on site and report to it subsequently. But on this occasion BaFin chose a different route.

In April 2016, the Department for the Prevention of Money Laundering required the 14 credit institutions to provide information on their transactions in Panama over the previous five years and to produce original documents, such as account statements. 10 banks stated that they had conducted transactions there on behalf of customers and submitted the original documentation. BaFin also required one further bank – not named in the Panama Papers – to provide similar information. The total amount of data submitted was just under 1.5 terabyte. In view of the large volume, the data will be evaluated by external experts once it has been reviewed by BaFin.

2.3 German institutions directly supervised by the SSM

2.3.1 Work in the joint supervisory teams (JSTs)

With the launch of the Single Supervisory Mechanism (SSM) in November 2014, the ECB took over the direct supervision of the banking groups classified as significant[31] – of which 21 are currently German (see Table 31 "German institutions supervised by the ECB under the SSM", Appendix, page 221). A joint supervisory team (JST) is responsible for each of these significant institutions (SIs). Employees of BaFin and the Bundesbank are represented in these teams as well as employees of the ECB.

The number of members in each JST and its composition vary depending on the size and complexity of the banking group. The JSTs are headed up by the ECB's JST coordinators. The core JST in each of the 21 JSTs for German SIs consists of a JST coordinator together with one sub-coordinator from BaFin and one from the Bundesbank. More than 100 BaFin employees from Banking Supervision are directly involved in the collective work in the JSTs. Up to 20 BaFin supervisors work together in individual JSTs. When dealing with specialist questions, they are assisted additionally by BaFin experts on policy issues.

In 2016, on the basis of an annual supervisory examination programme (SEP) for each individual institution, the JSTs carried out a total of 32 on-site inspections, 17 examinations of banks' internal models and a number of benchmark comparisons (thematic reviews) across different institutions focusing on various areas of emphasis (for example the implementation of BCBS 239). In over 30 cases, the JSTs investigated risk areas that had become noticeable in individual institutions using targeted deep dives. They also held workshops on these topics with the employees responsible for the particular area at the institutions. In total, in 2016, each JST conducted up to as many as 300 supervisory consultations with representatives of the institutions in individual cases.

In 2016, in addition to these SEP-related activities, the JSTs, in which BaFin employees are represented, participated in around 130 decision-making procedures of the ECB's Supervisory Board, dealing among other things with decisions on appointments to executive bodies (fit and proper assessments) or SREP decisions. BaFin's President, Felix Hufeld, is a member of the Supervisory Board.

The participants in the JSTs, which frequently have members from several different countries,

31 See the list of SSM institutions on the ECB's website: https://www.bankingsupervision.europa.eu/banking/list/who/html/index.en.html.

work together on a firm foundation of mutual trust. In this context, BaFin is able to contribute its wealth of experience and expertise as a national supervisory authority. Despite this, there remains room for improvement, for example with respect to coordination and consultation between members. Further points are that the overall activities of the individual participants need to be more closely aligned, while the process of optimising information and decision-making channels must continue.

2.3.2 Merger of DZ Bank and WGZ Bank

On 1 August 2016, the assets of WGZ BANK AG were transferred to DZ BANK AG in the context of a merger by absorption. This completed the process of consolidation at the top level of the cooperative sector in 2016. The two data centre operators Fiducia and GAD had already merged to form a collective cooperative IT services provider in the previous year. The primary cooperatives located in the Rhineland/Westphalia area of operations of the former WGZ BANK AG are now also looked after by the combined central bank. The merger of the top cooperative institutions has created the third-largest banking group in Germany.

There were frequent discussions in previous years on the merger intentions of the two cooperative central banks. The merger is intended as a response to the growing challenges in the market and from a regulatory point of view.

Supervisory approvals

The proposed merger triggered a large number of supervisory approval processes. BaFin carried out a number of qualifying holding procedures, for example. The appointment of the new management board for the merged institution and the capital increase carried out in connection with the merger were also monitored from a supervisory point of view. Both of the cooperative central banks were exempted from the EBA's EU-wide stress test carried out in 2016 in order to free up the resources necessary to implement the complex merger project.

The merger is not only one of the largest between German banking groups but also the first merger between two significant groups of institutions in the SSM. In order to handle the numerous merger-related special activities, the JST has created a merger sub-team at BaFin's suggestion, consisting of employees of the Deutsche Bundesbank, the European Central Bank and BaFin. The sub-team brings together all the merger-related processes and decisions, which are discussed and coordinated internally. Since BaFin has supervised both of the institutions for many years, it has made a major contribution to the joint merger sub-team with its extensive expertise.

The merged central institution reached a milestone that had been planned for a long time with its entry in the commercial register on 29 July 2016. However, the effects of the merger will still be felt for a long time after 2016. For example, the institution has announced a process of transformation towards a new holding company structure by the end of 2020. The objective is to combine the strategic and management functions of the DZ BANK Group and bring the business activities of the former central bank alongside the other cooperative institutions on the same level.

2.3.3 Recovery and resolution plans: BaFin's experience

During the year under review, BaFin evaluated more than 30 group and individual recovery plans. The large majority of these related to recovery plans of significant institutions from Germany, although there were also some from other SSM member states. BaFin reviews, among other things, whether the plans submitted comply with the requirements of the Bank Recovery and Resolution Directive (BRRD), set out in detail by the European Banking Authority and the German Recovery and Resolution Act (*Sanierungs- und Abwicklungsgesetz*), and whether they are capable of achieving the objectives of recovery planning.[32] The aim of recovery planning

32 See 1.7.

Results of the benchmark comparison

The 2016 benchmark comparison dealt primarily with the quantifiable elements of the recovery plans, in particular the analysis of the recovery plan indicators and the options available.

The benchmark comparison demonstrated that the credit institutions have an average of around 20 recovery options available, relating mainly to capital, liquidity and risk reduction. The institutions across all comparison groups considered the following measures to be particularly suitable for overcoming a crisis: the sale of equity investments, the sale of other assets, capital increases by the owner or third parties and a reduction in the scope of (new) business.

The institutions are required to identify material potential impediments to the recovery options in detail with the help of a feasibility assessment. On this point, the benchmark comparison showed that – as in the previous year – only a few institutions analysed these impediments and possible solutions for overcoming them in sufficient detail. The presentation of the financial and non-financial effects of the recovery options utilised also shows room for improvement. The evaluations included in the recovery plan, for example with respect to the assumed financial effects of a recovery option, were in many cases not yet adequately transparent.

The benchmark comparison also showed that in most cases the recovery plan indicators used in the recovery plans did not yet meet the requirements set out in the EBA guidelines for a minimum list of qualitative and quantitative indicators. The most frequently used indicators included – as in the previous year – the Tier 1 capital ratio, the total capital ratio and the liquidity coverage ratio. Recovery plan indicators from the EBA minimum list that were used only in isolated cases or not at all were the return on equity, the stock price variation, the cost of wholesale funding, the coverage ratio and credit default swaps of sovereigns.

is to prepare the institutions for potential crisis situations so that they are able to manage them using their own resources. The core elements of a recovery plan therefore include, among other things, options that the institution can take in a recovery situation in order to restore its financial viability on a sustainable basis. The institutions are also required to define indicators enabling them to take appropriate measures in good time in the event of a crisis. 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, and take into consideration sudden developments as well as those arising over a longer period of time.

In order to continue improving the quality of the recovery plans and to ensure that consistent standards of evaluation are applied, BaFin – as in the previous year – carried out a benchmark comparison of the recovery plans submitted jointly with the Deutsche Bundesbank (see info box).

BaFin is involved in the consultations on resolution plans via the SSM and also through its representation in resolution colleges (see info box on page 104). The plans act as a template for the resolution authorities in the event that a financial institution cannot overcome its financial difficulties on its own and has to be resolved. During the year under review, the Single Resolution Board (SRB) prepared around 50 such plans for the largest significant institutions. When doing so, the SRB consults the ECB in its SSM supervisory function in order to identify potential conflicts between the suggested resolution measures or possible resolution preparations and the going-concern approach. BaFin assists the ECB with the evaluation of the resolution plans in the joint supervisory teams.

BaFin evaluated 15 resolution plans of German and foreign SSM institutions during the year

under review. It also reviewed the results of evaluating a large number of other resolution plans of foreign institutions in preparation for meetings of the Supervisory Board. BaFin uses the knowledge gained in this process to continue developing its own evaluation procedures consistently and to contribute this knowledge to the SSM.

Its evaluation of the resolution plans is focused, among other things, on identifying the principal business activities and critical functions, which ideally match those in the recovery plan. In addition, from a going concern perspective, BaFin assesses the impediments to resolution identified by the resolution authority, the measures to deal with them and possible implications for supervisory activities. BaFin also assesses the particular institution's MREL ratio in the recovery plan. Since resolution plans have only been prepared since 2016 for the most part, more detailed analyses by the resolution and supervisory authorities are still needed.

2.3.4 EBA and ECB stress tests

In 2016, the EBA once again organised an EU-wide stress test for the 51 largest European banks following the test in 2014.[33] The test was carried out by the competent supervisory authorities under the direction of the EBA. The SSM was responsible for the test in the eurozone. In total, 37 institutions supervised directly by the ECB participated in the EBA stress test. For 56 other institutions, the ECB carried out an internal stress test in parallel, the SREP stress test.

Of the 22 significant German institutions, 19 took part in one of the two stress tests. Two institutions were exempted from the supervisory stress tests in view of their forthcoming merger.[34] One further institution was only included via consolidation by its parent company.

33 On the results of the EBA stress tests, see www.bafin.de/dok/8136220 (only available in German).

34 WGZ BANK AG and DZ BANK AG; for further details, see 2.3.2.

Resolution colleges

In 2016, the SRB established resolution colleges for cross-border institutions, in the same way as the supervisory colleges previously set up for those institutions. In addition to its work collaborating in the Single Supervisory Mechanism (SSM), BaFin also represents the supervisory authority for the German deposit guarantee schemes in these bodies. Its objective is to ensure that the resolution plan is not unduly disadvantageous from the point of view of German deposit protection – for example in the event of a bail-in. Currently, BaFin is performing this function in more than 20 resolution colleges.

Both of the stress tests were based on the EBA methodology for stress tests. Bearing in mind the principle of proportionality, however, BaFin allowed the institutions in the SREP test to use simplified procedures, in particular with respect to the extent of the data requested.

The main focus of the stress tests was on the future development of the own funds items. The effects had to be determined assuming a static balance sheet in a baseline scenario and a stress scenario over a three-year period until 2018. While the baseline scenario reflected the expected development of the overall economy as assumed by the EU Commission, the stress scenario took into account various systemic risks defined by the European Systemic Risk Board (ESRB). These included a low rate of economic growth with the related effects on the institutions' earnings situation, and a sudden increase in bond yields, which are extremely low in some cases. For the purposes of market risk, the stress scenario was supplemented by two historically observable scenarios.

In contrast to the 2014 stress test, legal risks were included for the first time as a component of operational risk. A further material change compared with 2014 was the explicit inclusion of hedging relationships, which were given a new definition in the EBA methodology.

Both stress tests focused on the following five types of risk:

1. credit risk (including securitisations and sovereign exposure)
2. market risk (including sovereign exposure)
3. net interest income
4. operational risk (including legal risks)
5. other income and expenses

Unlike in 2014, this time the institutions were permitted to depart from the static balance sheet assumption to a limited extent. For example – with the approval of the supervisory authorities – they were allowed to adjust the year-end results for non-recurring items, if the latter would have distorted the results because of the static balance sheet assumption. Non-recurring items in this connection include, for example, the disposal of business divisions or material staff restructuring measures.

There were also new developments in the quality assurance process. Since the SSM took over responsibility for conducting the stress tests for the first time in 2016, quality assurance was effected in an SSM-wide process led by the ECB and with the involvement of staff from the national supervisory authorities. BaFin employees participated both in the context of their national supervisory work in Bonn and also as members of various teams at the ECB in Frankfurt.

The EBA and the ECB handled the results of the stress tests differently. While the EBA published the results of the EBA stress test in full, the ECB did not publish the results of the SREP stress test.

2.3.5 Risk data aggregation – Thematic review on Basel Committee principles

Risk data aggregation and risk reporting were among the supervisory priorities in the SSM in 2016. The ECB undertook a thematic review to assess the implementation of BCBS 239, which BaFin has incorporated in the amended MaRisk.[35] At the same time, the intention was to determine benchmark standards to be used by banks and identify possible corrective measures for deficiencies. The findings of the thematic review will be included in the ECB's SREP decisions for the individual banks in 2017.

Phase 1

The thematic review consisted of two phases: in Phase 1, the JSTs evaluated the individual banks' documentation which they had specifically requested. They were assisted by a central SSM team, which provided guidance to help with the evaluations, in addition to training sessions and workshops. At the completion of Phase 1, the central team distributed a provisional, brief comparative report, which enabled the individual JSTs to identify the ranking of their own banks. The comparative report showed that the banks inspected were not yet able to satisfy the requirements of BCBS 239 in full and that further work is required.

There were difficulties in complying with almost all of the principles of BCBS 239. The institutions were particularly challenged by the requirements for data architecture and infrastructure, as well as the risk reports. Concluding talks were held with the banks, in which the JSTs discussed their assessments with the banks.

Phase 2

Phase 2 of the thematic review consisted of a fire drill and a data lineage exercise. For the data lineage exercise, the banks were required to provide evidence of the origin and aggregation of the data from the various data systems, legal entities and jurisdictions for selected data points in the supervisory reporting system. In the fire drill exercise, the banks had to demonstrate their capabilities for the rapid, accurate aggregation and reporting of credit risk and liquidity risk data. The JSTs required the data and reports to be submitted for this purpose. In addition, the banks' internal

35 On the implementation of BCBS 239 (Principles for effective risk data aggregation and risk reporting) in the amended MaRisk, see 1.3.

auditors had to assess the quality of the data and reports delivered on the basis of the criteria set by BaFin.

2.4 Institutions subject to German banking supervision

At the end of 2016, BaFin's Banking Supervision Directorate was responsible for supervising 1,628 banks – including 66 significant institutions (SIs).[36] 1,562 less significant institutions (LSIs) were directly supervised by BaFin. The number has declined significantly compared with the previous year. This is partly due to a large number of mergers in the banking sector, for example the merger of WGZ Bank and DZ Bank.[37] Also, since 2016 a number of banks have been monitored by the Securities Supervision Directorate instead of the Banking Supervision Directorate as before.[38]

The Banking Supervision Directorate subdivides the banks into four different groups of institutions (see Table 8 "Number of institutions by group of institutions"). The largest group of institutions, as before, is represented by the cooperative sector (976 institutions); the savings banks are the second-largest group (412 institutions). The institutions within the cooperative sector include the cooperative banks, DZ Bank and three other institutions. The savings bank sector comprises public-sector and independent savings banks together with the *Landesbanks* and Deka Bank.

The commercial banks, the third-largest group, comprise 171 institutions. They include the major banks, subsidiaries of foreign banks and the private banks. The smallest group with 69 banks is known as the group of other institutions. They include, among others, *Bausparkassen*, guarantee banks and special-purpose credit institutions.

Table 8 Number of institutions by group of institutions*

* As at 31 December 2016

	2016	2015	2014
Commercial banks	171	179	182
(of which SIs)	37	36	
Institutions belonging to the savings bank sector	412	422	425
(of which SIs)	11	11	
Institutions belonging to the cooperative sector	976	1,027	1,052
(of which SIs)	3	4	
Other institutions	69	112	121
(of which SIs)	15	16	
Total	**1,628**	**1,740**	**1,780**

2.4.1 Risk classification

The 1,562 LSIs are supervised by BaFin directly. It is assisted in this task by the Deutsche Bundesbank, which is responsible for ongoing monitoring. The risk profile of each LSI is an important supervisory tool and is updated by the supervisors at least once a year.

The risk profile of an institution affects how closely it is supervised. Each profile is based on the relevant audit report for the annual financial statements which is evaluated by the Bundesbank (see info box on page 107). The risk profiles also incorporate up-to-date risk analyses, the findings of special audits and information from other sources.

The risk classification of an institution is based on its risk profile. The decisive factors are the quality of the institution and its potential impact in the event of a solvency or liquidity crisis on the stability of the financial sector or financial market. In 2016, the risk matrix was expanded to a 4x4 matrix. Previously it had used a 3x4 matrix. The quality criterion still has four different categories (1 to 4). The impact criterion has now been expanded from three to four categories by splitting the "low" impact category into "low" and "medium-low" (see Table 9 on page 107).

36 See Appendix.

37 See 2.3.2.

38 On these institutions, see 2.4.12.

Online submission of auditors' reports

In October 2016, BaFin added another specialised procedure to its online reporting and publishing platform (*Melde- und Veröffentlichungsplattform* – MVP Portal).[39] The procedure "Submission of auditors' reports" is intended to be used by auditors and enables auditors' reports to be submitted electronically in a secure and verifiable manner in accordance with

- section 26 (1) of the Banking Act,
- section 3 (5) of the German Regulation on the Auditors' Reports of Certain Investment Undertakings (*Kapitalanlage-Prüfungsberichte-Verordnung*),
- section 3 (3) of the German Investment Services Examination Regulation (*Wertpapierdienstleistungs-Prüfungsverordnung*) and
- section 17 of the German Payment Services Supervision Act (*Zahlungsdiensteaufsichtsgesetz*).

The procedure saves time and money – both for BaFin and the submitting entity. Since BaFin passes on the reports submitted via the MVP Portal to the Bundesbank (single point of entry), auditors are relieved of one of their reporting obligations.

A glance at the distribution of the LSIs supervised by the Banking Supervision Directorate between the different fields in the 4x4 risk matrix shows that, compared with 2015, a higher percentage of the institutions have fallen into the "high" impact category. The reason for this is that in 2016 a number of high-priority LSIs were allocated to the highest impact category. High-priority LSIs are institutions subject to particularly close supervision on the basis of various indicators, such as their size, intrinsic risks or influence on the national economy.

2.4.2 Special audits

BaFin ordered 183 special audits in accordance with section 44 (1) sentence 2 of the Banking Act during the past financial year. It appointed the Deutsche Bundesbank to carry out the majority of these special audits. In comparison with 2015, however, BaFin made greater use of the option of awarding audits to external auditors.

Table 10 on page 108 shows the breakdown of special audits of LSIs in 2016 by areas of emphasis. Most of the audit work related to special audits initiated by BaFin, which include impairment-related special audits and audits pursuant to section 25a (1) of the Banking Act (MaRisk).

Table 9 Risk classification results of LSIs in 2016*

Institutions in %		Quality				Total
	Risk matrix	1	2	3	4	
Impact	High	0.0	0.5	0.1	0.0	0.6
	Medium	3.4	6.4	1.9	0.2	11.9
	Medium-low	18.6	31.4	4.7	0.5	55.2
	Low	4.9	20.0	6.4	1.0	32.3
	Total	**26.9**	**58.3**	**13.1**	**1.7**	**100.0**

* This table relates to LSIs under the supervision of the Banking Supervision Directorate.

39 See 2015 Annual Report, page 183.

Table 10 Breakdown of special audits of LSIs in 2016 by areas of emphasis*

As at 31 December 2016

	2016
Impairment-related special audits	19
Section 25a (1) of the Banking Act (MaRisk)	149
Cover	10
Market risk models	1
IRBA* (credit risk measurement)	4
AMA* (operational risk measurement)	0
Liquidity risk measurement	0
Total	**183**

* This table relates to LSIs under the supervision of the Banking Supervision Directorate. IRBA stands for internal ratings-based approach and AMA stands for advanced measurement approach.

As a general rule, the impairment-related special audits are conducted by auditors on BaFin's instructions. The impairment analysis relates to loan collateral and the adequacy of the provision for credit risks.

Audits in accordance with section 25a (1) of the Banking Act are intended to examine the adequacy of an institution's risk management systems. The minimum conditions that must be satisfied for a risk management system to be adequate are set out in detail in the MaRisk. Among other things, they include provisions affecting the design of an institution's internal control systems, its organisational and operational structure and, in particular, its risk management processes.[40]

In addition to the knowledge acquired in the course of its supervisory activities, the audit reports for annual financial statements are an important source of information for BaFin. If the information available is not sufficient to clarify a particular issue, BaFin orders a special audit. As well as for the purpose of clarifying particular issues, it also orders audits on a routine basis if the most recent audit of an institution was some time ago. Institutions may also request special audits.

In 2016, BaFin carried out five special audits on the initiative of the institutions. Four of these

Table 11 Breakdown of special audits of LSIs in 2016 by groups of institutions

As at 31 December 2016

	Commercial banks	Savings bank sector	Cooperative Sector	Other Institutions
Impairment-related special audits	0	1	18	0
Section 25a (1) of the Banking Act (MaRisk)	17	41	84	7
Cover	0	9	0	1
Market risk models	1	0	0	0
IRBA (credit risk measurement)	2	0	0	2
AMA (operational risk measurement)	0	0	0	0
Liquidity risk measurement	0	0	0	0
Total	**20**	**51**	**102**	**10**
Audit ratio in %*	**11.7**	**12.4**	**10.5**	**14.5**

* Number of audits as a proportion of the number of institutions in each group of institutions. This relates to LSIs supervised by BaFin's Banking Supervision Directorate.

40 On the amended MaRisk, see 1.3.

requested audits related to approval of the credit risk measurement procedure under the internal ratings-based approach (IRBA), while one was an audit of an institution's market risk model.

Of the total of 183 special audits in 2016, 10 were concerned with the cover for *Pfandbriefe*. In accordance with the German *Pfandbrief* Act (*Pfandbriefgesetz*), cover audits should generally take place every two years.

The breakdown of special audits of LSIs by the individual groups of institutions is shown in Table 11 on page 108. The majority of the special audits were carried out in the cooperative sector, since this group of institutions has by far the greatest number of institutions. The audit ratio in the cooperative sector – i.e. the ratio of the number of special audits to the total number of institutions within a group – amounted to 10.5 %. In total, BaFin carried out audits initiated by itself for 11 % of the LSIs under supervision.

Table 12 shows the breakdown of special audits of LSIs initiated by BaFin in 2016 by risk class. In accordance with the principle of risk-based supervision, BaFin conducted the highest proportion of special audits, 55.6 %, in the group of institutions where a solvency or liquidity crisis would potentially have a high impact on the stability of the financial sector.

2.4.3 Objections and measures

BaFin recorded a total of 415 objections and measures across all four groups of institutions in 2016 (see Table 13 "Supervisory law objections and measures in 2016" on page 110).[41] Institutions in the cooperative sector were the most affected as they represent by far the largest group of institutions.

Formal supervisory action not always necessary

In general, the approach adopted by BaFin is to make direct contact with the institutions concerned at the first sign of deficiencies. Its objective is to rectify the emerging deficiencies at the earliest possible stage. In most cases, the institutions are highly cooperative and remedy the deficiencies immediately. As a consequence, BaFin had to take formal measures against managers or members of

Table 12 Breakdown of special audits of LSIs initiated by BaFin in 2016 by risk class

As at 31 December 2016

Special audits initiated by BaFin		Quality of the institution				Total	Institutions in %*
		1	2	3	4		
Impact	High	0	4	1	0	5	55.6
	Medium	5	11	11	1	28	15.5
	Medium-low	24	50	12	1	87	10.3
	Low	10	28	7	3	48	9.8
	Total	**39**	**93**	**31**	**5**	**168**	**11.0**
	Institutions in %*	**9.5**	**10.5**	**15.5**	**20.0**	**11.0**	

* Percentage of the total number of institutions in the respective quality/impact category accounted for by the audits.

41 On the distinction between measures and sanctions, see chapter II 3.1. On sanctions under the Banking Act, see chapter II 3.2.

Table 13 Supervisory law objections and measures under the Banking Act in 2016*

As at 31 December 2016

Type of measure		Group of institutions				
		Commercial banks	Savings bank sector	Cooperative sector	Other institutions	Total
Substantial objections/letters		10	14	38	20	82
Measures against managers	Dismissal requests***	4	1	0	0	5
	Cautions	1	1	0	0	2
Measures against members of supervisory/ administrative boards	Dismissal requests***	0	0	0	0	0
	Cautions	0	0	0	0	0
Measures related to own funds/liquidity, exceeding the large exposure limit (sections 10, 13 and 45 of the Banking Act)		63	89	158	5	315
Measures in accordance with section 25a of the Banking Act		4	1	0	0	5
Measures in accordance with sections 45, 45b and 46 of the Banking Act**		6	0	0	0	6
Total		**88**	**106**	**196**	**25**	**415**

* This relates only to LSIs supervised by BaFin's Banking Supervision Directorate.
** Measures to improve own funds and liquidity (section 45 of the Banking Act), in the case of organisational deficiencies (section 45b of the Banking Act) and in the case of specific danger (section 46 of the Banking Act).
*** These figures comprise formal and informal measures and dismissal requests from third parties. On sanctions under the Banking Act, see chapter II 3.2.

the supervisory or administrative boards of an institution only in isolated cases during the past year.

The main formal measures taken in 2016 related to the SREP notices, which dealt with own funds and liquidity measures. These are notices issued on the basis of the guidelines on common procedures and methods for the supervisory review and evaluation process (SREP) published by the EBA on 19 December 2014. BaFin sent out a total of 303 SREP notices in 2016.[42]

2.4.4 Situation of the private commercial, regional and specialist banks

For many of the private commercial, regional and specialist banks, 2016 was characterised by rising capital requirements from a regulatory point of view. For example, BaFin sent SREP notices[43] on the subject of higher own funds requirements to about half of the institutions in this group. The tighter requirements cover interest rate risk in the banking book in particular, but also other material risks not already dealt with in Pillar I of the framework, i. e. under the Capital Requirements Regulation (CRR) or the Solvency Regulation. The increased requirements create different challenges for the institutions due to their very different levels of capital resources. The group of institutions which did not receive a SREP notice are subject to BaFin's general administrative act dated 23 December 2016, which stipulates additional own funds requirements relating to interest rate risk in the banking book.

Low level of interest rates

The low interest rate environment which again prevailed in 2016 was the major factor affecting the business environment of the private

42 On the SREP, see 2.1.

43 See 2.1.

commercial, regional and specialist institutions, even if its economic impact differed due to the wide range of business models. However, more or less all of the institutions are facing pressure to reduce costs. As a result, they too are becoming ever more interested in financial technologies, or fintech for short.[44] The private commercial, regional and specialist institutions are making increased use of financial technologies to cut costs and offer customers up-to-date and timely services by employing IT processes.

Digitalisation

In addition, the market is experiencing a surge of innovative providers from the fintech sector with new business models. Specific business models, for example, are based on mobile banking transactions conducted using a smartphone, the establishment of online trading and brokerage platforms, the use of automated investment strategies (robo-advisors) or are aimed at project financing for renewable energies. In addition to simplifying processes, these undertakings are also aiming to use the increasing digitalisation of the banking business to collect user data for the purpose of offering future products and services that match the customer's profile, as is already normal practice in other areas of the economy. To date, fintech companies have mainly offered their technology to established institutions or have entered the market in their own name only in cooperation with authorised institutions. In 2016, BaFin granted a banking licence to two subsidiaries of fintech companies.

2.4.5 Situation of the savings banks

The business environment of the savings banks was also mainly affected by the historically low level of interest rates together with regulatory changes. Nevertheless, the affiliated institutions once again succeeded during the past financial year in achieving an overall result that was satisfactory. As expected, net interest income – by far the most important source of earnings for the savings banks – declined once again. By contrast, net commissions received recorded a modest upward trend. The increase was not sufficient to offset the decline in net interest income, however. Risk provisioning expenses continued to be extremely low, in both the lending and the securities business. Reserves were once again significantly increased, if not by as much as in the past, so that overall the reported net profit for the year matched the level of previous years.

Low level of interest rates

The reason for the decline in net interest income was the persisting low interest rate environment which is presenting increasing earnings problems for the savings banks. Many affiliated institutions earn a portion of their interest income from maturity transformation, i. e. exploiting the gap between short-term and long-term interest rates on the capital market. However, because the yield curve has become flatter and flatter in recent times, the income from maturity transformation has steadily receded. At the same time, maturity transformation involves an increased interest rate risk for the institutions. In order to take this risk and other material risks into account from a supervisory point of view, BaFin carried out an individual capital quantification (SREP[45]) for around 20 % of the savings banks during the past year. It then increased the minimum capital requirements for the large majority of the institutions inspected by an average of around 1.6 percentage points, which is roughly equivalent to the capital add-on for the other groups of banks. As a transitional measure, BaFin used a general administrative act to order the capital add-on for the remaining savings banks that were not individually inspected. An individual SREP capital quantification is expected to be carried out for all of the savings banks by the end of 2017.

Mortgage Credit Directive

As the affiliated institutions have a relatively strong presence in residential building lending, they are affected to a greater extent by the

44 See chapter II 5.1.

45 On the SREP, see 2.1.

European Mortgage Credit Directive[46], which was transposed into German law in March 2016. The legislation imposes numerous new obligations on the credit institutions in order to protect consumers. For example, the Directive requires the institutions to carry out an even stricter review of their customers' creditworthiness in future for the purpose of residential building loans. The consequence for the banks and savings banks is that granting real estate loans is now more labour-intensive and requires more time.

Digitalisation

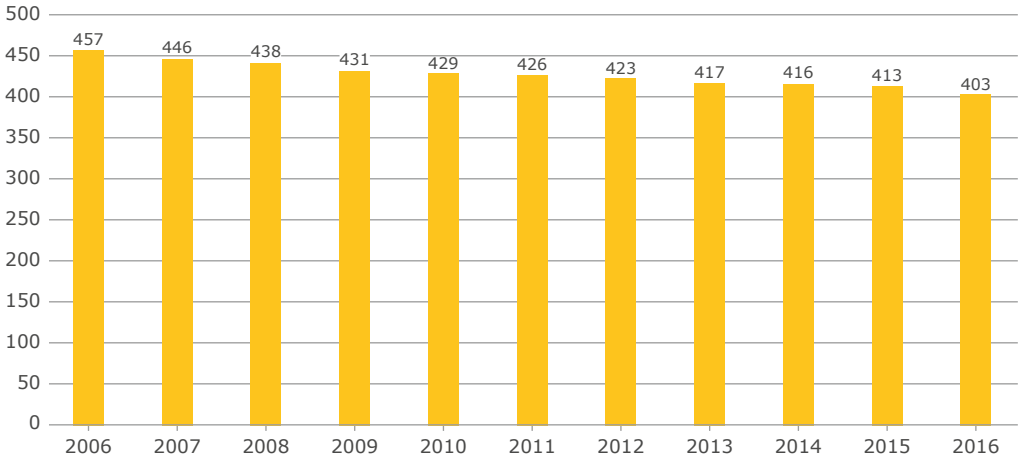
Since the behaviour of customers has changed in response to the increasing digitalisation of the banking business and their visits to the branches are becoming less and less frequent, the savings banks reduced their branch network again in 2016 in order to save costs (see Figure 2 "Number of savings banks"). The institutions will face additional expenses with the expansion of their online presence and the modernisation of their IT systems. The savings banks are responding to the growing pressure on costs by combining to form larger entities and merging with neighbouring savings banks. The rate at which these mergers are taking place is expected to accelerate in 2017. The savings banks' average total assets has now risen to around € 1.2 billion as a result of the mergers completed in recent years.

2.4.6 Situation of the *Bausparkassen*

The continuing low interest rate environment represented a challenge for the *Bauspar* sector in 2016 as well. Loans granted for residential building purposes increased once again, although modestly, with the growth mainly attributable to pre-financing and bridging finance loans. The proportion of *Bauspar* loans, on the other hand, continued to decline. This was reflected in a further reduction in the share of total assets of the individual *Bausparkassen* represented by *Bauspar* loans. However, savings targets continued at a high level in 2016 as well.[47]

The declining proportion of *Bauspar* loans once again contrasted with a further increase in *Bauspar* deposits across the sector in 2016.[48] One reason for this is the lack of interest on the part of *Bauspar* customers in taking up *Bauspar* loans that are ready to be disbursed but bear a high rate of interest in comparison with the current interest rate environment. At the same time, older *Bauspar* contracts also feature a

Figure 2 Number of savings banks*



* This statistic does not include eight *Landesbanks* and Deka Bank.

46 On the Mortgage Credit Directive, see chapter II 1.7.

47 Deutsche Bundesbank, Banking statistics, March 2017.

48 Loc. cit.

comparatively high rate of deposit interest, which explains the low level of interest on the part of many *Bauspar* customers in terminating their contracts.

Impact on results of operations

This is having a significant impact on the results of operations of the *Bausparkassen* throughout the sector. The reason is that there is no corresponding interest income from *Bauspar* loans to offset the interest expenses for *Bauspar* deposits paying a comparatively high rate of interest. Furthermore, the business activities of the *Bausparkassen* are mainly restricted to residential real estate financing and their investment options to low-risk investments. However, an amended *Bausparkassen* Act (*Bausparkassengesetz*) came into effect at the end of 2015. While the new provisions it contains do not eliminate the impact of the low interest rate environment on the *Bausparkassen*, the requirements aimed at strengthening earnings power are nevertheless helping to lessen the consequences in the long term.[49]

Reactions to the low level of interest rates

The *Bausparkassen* themselves also endeavoured to deal with the consequences of the low interest rate environment during the financial year. They pushed further ahead with the introduction and distribution of new lower-interest tariffs, they created leaner processes and reduced their costs.

Terminations

But the *Bausparkassen* are also continuing their efforts to reduce the proportion of high-interest contracts in their portfolio. This was made clear by the large number of terminations again announced by *Bausparkassen* in 2016, relating to *Bauspar* contracts that are over-saved or have been eligible for allocation for more than 10 years, which were reported in the media. Over-saved *Bauspar* contracts are those contracts where the *Bauspar* loan can no longer be disbursed because the payments by the *Bauspar* customer have already reached the agreed savings target. The courts consistently regard the termination of such *Bauspar* contracts as permissible.

The Federal Court of Justice (*Bundesgerichtshof*) ruled in principle on 21 February 2017 that *Bausparkassen* may terminate *Bauspar* contracts that have the conditions for granting a loan for more than 10 years without the savers having taken out the allocated loan. Allowing a *Bauspar* contract to run for more than 10 years simply as a savings account was in conflict with the meaning and purpose of building savings, according to the Court's decision.

2.4.7 Situation of the cooperative banks

The cooperative banks performed well in the 2016 financial year despite the difficult market environment. However, the institutions in 2016 once again failed to achieve the level of success enjoyed from 2009 to 2014. The reason for this in their case as well is the low interest rate environment, which has had a noticeable impact on net interest income. The considerable efforts to control costs over the past 10 years are having a clearly visible effect over the long term and are offsetting the decline in net interest income to a significant extent. The ratio of the sector's operating result to total assets was only just below the long-term average. As the expected measurement losses were below the long-term average, the institutions in the cooperative sector were again able to make adequate provision for future risks by adding to reserves in 2016.

However, due to an excess of liquidity at low interest rates, the banks will generate lower income than in the past for the foreseeable future. The cooperative sector is endeavouring to counteract this with further cost reductions.

The mergers of Fiducia and GAD (computer centres) and of DZ Bank and WGZ Bank

49 On the amended version of the *Bausparkassen* Act, see 2015 Annual report, pages 116 ff.

(central banks)[50] have generally lifted the potential for consolidation at sector level. It is now up to the primary institutions to reduce costs. The renewed increase in the number of mergers is evidence of the endeavour to transfer regulatory costs to larger entities. While in 2015 the number of primary institutions declined by 2.6% to 1,022, the rate of mergers doubled in 2016. The number of primary cooperatives shrank from 1,022 to 972, equivalent to a fall of 4.9% (see Figure 3 "Number of primary cooperative institutions").

When asked about their results of operations in the low interest rate environment in discussions with BaFin, the management boards of primary institutions reported that they were planning additional measures to cut costs. Accordingly, topics such as branch closures and focusing on core regions – together with reductions in staff numbers – grew in importance in 2016. The primary cooperatives have made efforts to compensate their customers for the reductions in the branch network by expanding their online banking services. In addition, they have shown an increasing tendency to reduce dividend payments to their members in order to strengthen their financial position.

End of free current accounts

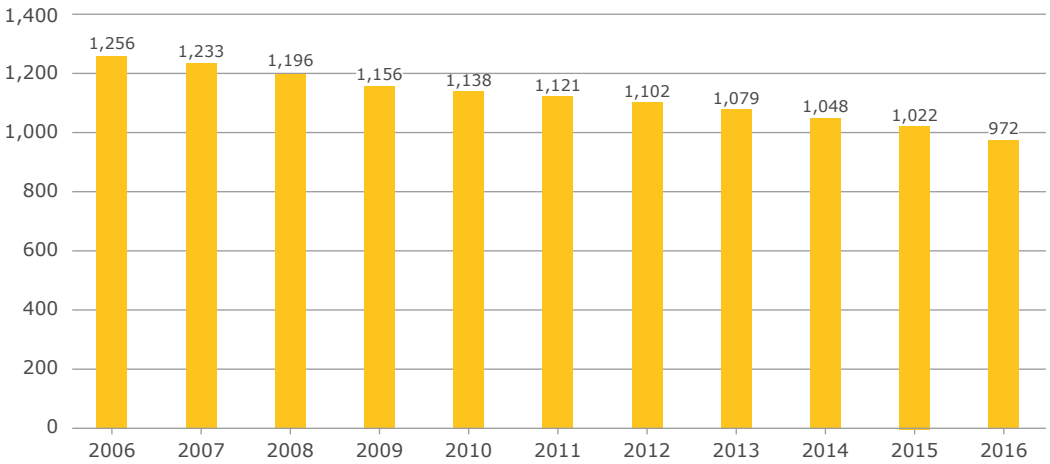
Another observable trend is that primary institutions are increasingly charging prices for their services that reflect the use made of them. Most noticeably: fewer and fewer institutions are offering free current accounts. Given the persistent low level of interest rates, many institutions can no longer subsidise this service out of interest income. In doing so, they are following a trend that has already been observed in other areas of the banking industry for some time.

Negative interest for retail customers has become a major topic in the cooperative sector in 2016. Some institutions adopted a policy of demanding penalty interest from their customers this year, even if the majority of primary institutions continued to indicate that they would not follow suit. It remains to be seen whether this trend will spread throughout the cooperative sector during 2017.

2.4.8 Situation of the foreign banks

As in the past, foreign banks continue to play a major role in the German financial market. Foreign banks' customer deposits remained at a high level in 2016 despite the general decline in the level of interest rates. In addition to the deposit business, the business activities of these banks are concentrated primarily on the lending business, private banking, investment banking and custodian bank operations. Export finance and payment transactions also play

Figure 3 Number of primary cooperative institutions



50 See 2.3.2.

a significant role in the business activities of these institutions.

The establishment of the Single Supervisory Mechanism (SSM) also affects foreign banks with operations in Germany. BaFin is currently represented in a total of 15 joint supervisory teams (JSTs)[51], which also supervise banks from other countries with operations in Germany in the context of group supervision.

Most of the foreign banking entities operating in Germany qualify as less significant institutions (LSIs). Recently, however, a number of foreign banks that were classified in principle as less significant were identified separately in the light of their importance. These banks are referred to as high-priority less significant institutions and are supervised more closely by BaFin.

Third-country branches

Since the ECB does not have supervisory powers for monitoring branches of banks from third countries, BaFin remains solely responsible for this group of institutions. They are deemed to be credit institutions pursuant to section 53 of the Banking Act and are therefore subject for the most part to the same supervisory standards as legally independent credit institutions. As before, the supervision of third-country branches has not been harmonised across Europe, with the result that there are national differences in the regulatory framework.

It was already noticeable in the past that non-European foreign banks in particular were pushing ahead with the centralisation of their European activities. Based on a European headquarters, they are able to use European passporting rights to service the remaining markets through legally dependent EU branches or in the context of cross-border services.

Brexit

International groups of banks are weighing up similar strategic reorganisations – also as a result of Brexit. The institutions have to assume that, in the event of the United Kingdom leaving the European Union, the ability to use EU passporting rights would no longer be available. In order to maintain their existing relationships with European customers and gain new customers from the EU in addition, the banks could find it necessary in future to continue their business activities conducted to date in the United Kingdom via a different entity located in the European Economic Area.

BaFin is also actively approaching interested undertakings, for example with the offer of workshops or individual consultations. As the German supervisory authority, its aim is to provide the undertakings with clarity and support, as well as a reliable framework. Acting on the initiative of BaFin's President Felix Hufeld, for example, BaFin invited around 50 representatives of foreign banks to a workshop in Frankfurt am Main on 30 January 2017, for the purpose of an exchange of views on supervisory issues relating to Brexit.[52]

Iranian banks

Following the widespread lifting of sanctions against Iran in 2016, Iranian credit institutions located in Germany are once again permitted to provide banking services.

2.4.9 Situation of the finance leasing and factoring institutions

Finance leasing and factoring institutions (see info box on page 116) are generally benefiting from the growing readiness across the economy as a whole to make capital investments. The ifo Institut forecast growth in investments for the German economy as a whole of around 2.9 % for 2016[53], after they had already risen by around 3 % to € 341.8 billion in the previous year. As in previous years, the leasing and factoring institutions accounted for an above-average share of this increase.

51 See 2.3.1.

52 See chapter I 8.

53 ifo Institut: "Eurozone economic outlook" (11 January 2017), page 1.

Finance leasing and factoring institutions

Finance leasing institutions provide the economy with investment goods. Factoring institutions provide indirect assistance to companies with financing their investments by providing liquidity. For supervisory purposes, the two are brought together as Group V financial services institutions.

According to the Federal Association of German Leasing Companies (*Bundesverband Deutscher Leasing-Unternehmen e.V.*), the leasing industry achieved growth of 9 % in its new equipment goods business in 2016 compared with the previous year.[54] Factoring revenues in the first half of 2016 also recorded an above-average increase of 4 % compared with the prior-year period to € 104.51 billion, according to a survey by the German Factoring Association (*Deutscher Factoring-Verband*).[55] As in previous years, therefore, the Group V institutions continued to grow in importance as a source of financing for German companies in comparison with other forms of finance.

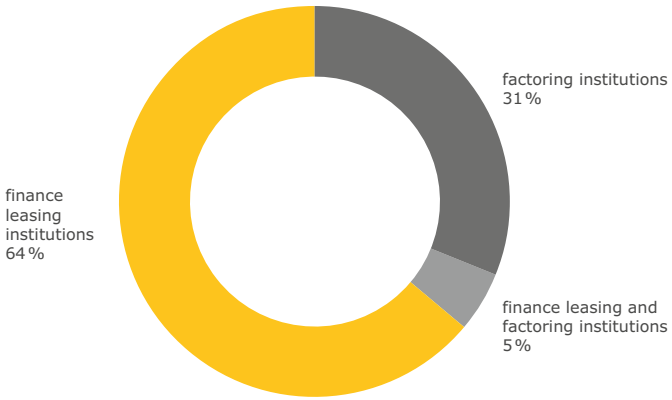
Irrespective of the growth in revenue of the two sectors, the number of Group V institutions under supervision at 31 December 2016 changed as follows: there were 334 pure finance leasing institutions (64 %; previous year: 352), 160 pure factoring institutions (31 %; previous year: 163) and 26 institutions engaged both in finance leasing and in factoring (5 %; previous year: 25; see Figure 4 "Breakdown of the Group V institutions"). This shows a small decline in the number of Group V institutions – in keeping with the general trend towards consolidation in the financial sector.

New authorisations

The number of new authorisations in 2016 rose compared with the prior year, while the number of authorisations terminated recorded a negligible decline. The year saw a continuation of the easing with respect to changes in authorisations observed for a number of years. During the year under review, BaFin approved 21 new applications for authorisation pursuant to section 32 of the Banking Act. A total of 36 authorisations ended in 2016, 20 of them as the result of waivers, including cases where the intention was to pre-empt a formal suspension of the authorisation by BaFin. In 14 cases the

Figure 4 Breakdown of the Group V institutions

As at 31 December 2016



54 Federal Association of German Leasing Companies, press release dated 24 November 2016.

55 German Factoring Association, press release dated 24 August 2016.

authorisation ended following a merger with another institution. In 1 case the authorisation was revoked on the basis of section 35 (2a) of the Banking Act. In addition, 1 authorisation expired for statutory reasons pursuant to section 35 (1) of the Banking Act. BaFin also commenced formal proceedings to revoke an authorisation in 1 case in December 2016.

Qualifying holding proceedings

BaFin initiated qualifying holding proceedings pursuant to section 2c of the Banking Act in conjunction with the German Holder Control Regulation (*Inhaberkontrollverordnung*) in a total of 103 cases in 2016 due to the proposed acquisition of a significant shareholding in a Group V institution. 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. In one case BaFin initiated formal proceedings to prohibit the sale of a holding and the exercise of the associated voting rights on the basis of section 2c (2) of the Banking Act.

Personnel changes

BaFin again received numerous notifications of changes in personnel at Group V institutions in 2016. Notifications were received of the intention to appoint 94 new members of management or commercial attorneys-in-fact, and notification was given that the appointments of 41 members of supervisory or advisory boards had been completed. It is BaFin's responsibility to review the fitness and propriety of these persons. In eight cases, it issued warnings or letters of disapproval to managers of Group V institutions or expressed its disapproval in writing with respect to members of supervisory or advisory boards.

Tighter supervision of money laundering

In addition to their obligations under the Banking Act, Group V institutions are also subject to the requirements of the German Money Laundering Act (*Geldwäschegesetz*). In 2016, BaFin stepped up its monitoring activities to prevent money laundering, terrorist financing and other punishable offences at Group V and other financial services institutions. BaFin has been inspecting the institutions' internal measures for the prevention of money laundering more closely since 2016, using systematic samples selected on the basis of a risk-oriented approach. The assessment of the samples revealed significant deficiencies in some cases – firstly with respect to the implementation of the statutory requirements, and secondly with regard to the audit reports for annual financial statements. The latter were not sufficiently informative, with the result that BaFin required additional information and evaluations from the auditors. Additionally, in many cases the institutions' own documentation was inadequate and/or the AML risk analysis, which has to be updated annually, was incomplete.

Review of intrinsic value calculations

The balance sheet and profit and loss account give an incomplete view of the actual position of leasing institutions, since their presentation of the economic profitability of leasing transactions is often inadequate. In order to show their future profitability and manage their risks, leasing institutions generally prepare an intrinsic value calculation. The intrinsic value calculations, which are submitted to funding partners, investors, shareholders and BaFin, are presented in a format which is largely standardised and issued by the Federal Association of German Leasing Companies. Nearly all the institutions now use this format.

Nevertheless, a variety of items provide scope for flexibility and different valuation methods. BaFin has set itself the objective of investigating this scope more closely to enable it to identify differences in the valuation approaches used in the intrinsic value calculations of the leasing institutions more easily, and to ask critical questions where necessary. BaFin laid the foundations for this in 2016 by electronically recording the intrinsic value calculations submitted for the first time, using a systematic procedure and with the assistance of the Deutsche

Bundesbank. This – now expanding – database is intended to help BaFin distinguish between riskier and more conservative valuation approaches, which may have consequences, for example, for the supervisory assessment of the institutions' calculations of risk-bearing capacity and the going concern assumption. This is the assumption that an entity will be able to continue its business activities in accordance with section 252 (1) no. 2 of the Commercial Code (*Handelsgesetzbuch*) and constitutes a fundamental assumption underlying accounting in accordance with commercial law.

Audit emphasis on IT security

In times of increasing digitalisation and networking, IT security and cybercriminality are becoming ever more important topics for financial services providers as well.[56] The invoices and end customer data of factoring customers have been passed on to the factoring institution for a long time, in most cases electronically. The same applies to dealer-based leasing. In the latter case, the authorised dealer (for example the car dealership) enters the customer data on site into an electronic mask and transmits them to the leasing institution in digital form. The institution then carries out the credit check, as a rule primarily also electronically, for example by assessing the customer's creditworthiness and the value of the item. The result is then relayed back to the dealer electronically. The ongoing processing of the contract is also usually based mainly on IT applications, and in addition customers frequently use access portals via the Internet. The increasing number of interfaces and the growing extent of digitalisation represent potential gateways for hackers, but also entail dangers with respect to the validity and availability of data. Due to the considerable negative consequences that malfunctioning IT systems can have for institutions and their customers, and in view of the increasing threat posed by cybercriminality, BaFin has decided in its supervisory strategy for 2017 to make the IT security of Group V institutions an area of emphasis for supervision, and to monitor the larger institutions within this group more closely for that purpose.

56 On this subject, see also chapter II 5.3.

2.4.10 Situation of the payment institutions and e-money institutions

In 2016, BaFin granted three new authorisations and two authorisations to existing institutions under the Payment Services Supervision Act. As before, applications for authorisation and authorisation proceedings represent a focal area for supervisory activities pursuant to the Payment Services Supervision Act. Applicants frequently describe the great potential they envisage for their payment services offered online or via mobile devices. Following the entry into force of the Second Payment Services Directive (PSD2), there has been increased interest in authorisations for the provision of payment services. The application proceedings during the year under review, however, still complied with the existing version of the Payment Services Supervision Act. The implementation of PSD2 is due in 2017 and must be completed by 13 January 2018.

As before, several new notifications for payment or e-money institutions from other EU member states are received on a weekly basis. The extent of the payment services actually provided by these institutions in Germany is unknown due to the lack of statistical information. The same applies to the agents notified for providers of remittance services.

2.4.11 *Pfandbrief* business

The *Pfandbrief* business performed relatively well again in 2016 despite a difficult market environment. Current global economic and political uncertainties – such as Brexit and the developments in Turkey – had little effect in the end on demand for *Pfandbriefe* as a conservative investment product with a high standard of quality. A trend towards benchmark issues can be discerned in the *Pfandbrief* market; for the first time since the sovereign debt crisis, a few institutions are also accepting

Table 14 Gross *Pfandbrief* sales

Year	Mortgage *Pfandbriefe* (€ billion)	Public-sector *Pfandbriefe* (€ billion)	Total sales (€ billion)
2012	42.2	14.3	56.5
2013	33.9	15.6	49.5
2014	30.6	15.3	45.9
2015	42.6	15.5	58.1
2016	35.1	10.4	45.5

peripheral countries in their cover pool again. Whether new product types – such as the "green *Pfandbrief*" marketed as a sustainable investment – will survive in the long term remains to be seen. The ECB has become by far the largest investor in the *Pfandbrief* market and the covered bond market as a whole in the context of its third covered bond purchase programme (CBPP3), while traditional investors such as insurers, pension institutions and asset managers are holding back from *Pfandbriefe* as a result of the low returns, which can even amount to a negative rate of interest.

Decline in volume of *Pfandbrief* sales

2016 recorded a lower sales volume of *Pfandbriefe* in comparison with the previous year. Following an increase in 2015 for the first time since the start of the financial crisis, sales have now returned to the level of 2014. The main factors responsible for the decline in sales were alternative funding options in the form of the ECB's targeted longer-term refinancing operations (TLTRO II) and the continuing low interest rate environment. In total in 2016, *Pfandbriefe* with a volume of €45.5 billion were sold. Measured by issue volume, sales of mortgage *Pfandbriefe* (including ship and aircraft *Pfandbriefe*, although as before these were relatively insignificant) amounting to €35.1 billion (previous year: €42.6 billion) were more than three times higher than those of public-sector *Pfandbriefe* with an issue volume of €10.4 billion during the past year (previous year: €15.5 billion) (see Table 14 "Gross *Pfandbrief* sales").

The continued decline in the total volume of outstanding *Pfandbriefe* was due as in the past to a high level of maturities and relatively lower new issuance activity. More mortgage *Pfandbriefe* than public-sector *Pfandbriefe* were outstanding for the first time in 2015. This trend continued in 2016. The volume of public-sector *Pfandbriefe* outstanding at the end of 2016 recorded an above-average decline to €155.2 billion (previous year: €180.5 billion). By contrast, the volume of mortgage *Pfandbriefe* outstanding at the end of 2016 (including ship and aircraft *Pfandbriefe*) remained almost unchanged at €203.7 billion (previous year: €203.9 billion), giving a total volume

Table 15 Volumes of outstanding *Pfandbriefe*

Year	Mortgage *Pfandbriefe* (€ billion)	Public-sector *Pfandbriefe* (€ billion)	Total sales (€ billion)
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
2016	203.7	155.2	358.9

of *Pfandbriefe* outstanding of €358.9 billion (previous year: €384.4 billion) (see Table 15 "Volumes of outstanding *Pfandbriefe*" on page 119).

Since there is a favourable environment for real estate financing, the level of demand for real estate loans, which can be refinanced using mortgage *Pfandbriefe*, remains high. The proportion of mortgage *Pfandbriefe* will also continue to increase in the future. Public-sector *Pfandbriefe*, whose main uses currently are still the refinancing of traditional local government funding and of state-backed export finance, will only play a minor role in comparison.

2.4.12 Situation of the securities trading banks

At the start of 2016, BaFin reorganised the operating supervision of securities trading banks and stock exchange brokers and brought them together in the Securities Supervision Directorate. The background to the change is that the focus of their activities is on securities trading and they are classified as investment firms within the meaning of the EU Capital Requirements Regulation (CRR).

The business environment also presented challenges to securities trading banks and exchange brokers during the past year. Stock exchange turnover figures recorded only modest growth as retail investors continued to hold back – despite the positive developments on the DAX and the extremely low interest rates. In addition, the bond market remained at a low level following the ECB's purchase programme.

Difficult earnings situation

The earnings situation in stock exchange trading therefore remains difficult, with the consequence that the institutions are continuing to look for new business areas and sources of income. Only a few institutions were able to benefit from the market for corporate finance activities, in particular for small and medium-sized entities. Moreover, once again in 2016, 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 are either already authorised by BaFin to engage in proprietary trading or able to engage in cross-border trading using the EU passport because they hold corresponding authorisation from an EU member state. The restructuring measures implemented by major energy groups triggered various processes of reorganisation in energy derivatives trading at securities trading banks and exchange brokers. BaFin monitored these processes in particular from the point of view of qualifying holding procedures.

Alternative trading platforms

The development of alternative trading platforms continues to make progress. None of the securities trading banks or stock exchange brokers took advantage of the option of operating a multilateral trading facility (MTF).

Consolidation process

Against the background of competitive pressure and the difficult environment, the process of consolidation continued during the past year. One institution surrendered its authorisation as a securities trading bank entirely. Another institution reduced the scope of its activities and will conduct its business in future as a financial services institution. A further institution split off its corporate finance activities which will be continued in a new financial services institution.

In 2016, BaFin applied to the competent insolvency court to initiate insolvency proceedings in relation to the assets of a securities trading bank. The bank's senior management had previously notified BaFin that the bank was insolvent. Only BaFin itself can apply to open insolvency proceedings relating to the assets of an institution under its supervision. The securities trading bank in question was the lead broker responsible for order books on a number of German stock exchanges.

When the securities trading bank was able to demonstrate to BaFin that it was once again able to meet its payment obligations, BaFin withdrew its application to initiate insolvency proceedings since the grounds for the proceedings were no longer valid.

Organisational weaknesses

In the course of its ongoing supervisory activities during the past year, BaFin once again identified weaknesses in the organisation of some institutions, particularly in risk management and controlling, risk-bearing capacity concepts and the documentation of transactions. The institutions rectified these deficiencies after BaFin had requested them to do so.

In one case, BaFin ordered a special audit to examine the adequacy of the risk management system and the system of governance. The institution had previously entered a critical situation as a result of settlement problems relating to the execution of stock exchange transactions. The special audit found that the institution's risk management system (limit system and limit authorisation) was inadequate for the type, size, complexity and riskiness of the transactions examined. BaFin is currently considering appropriate supervisory actions for similar breaches of the obligation to maintain a proper system of governance, which could range from ordering specific organisational measures to warning or removing senior managers or to revoking the authorisation.

In one case, BaFin required a securities trading bank, following an earlier hearing, to comply with its own funds requirements on the basis of the consolidated situation of the financial holding company. A combination of own funds and the principal risk positions is intended to ensure that the concentration of risk in the group is adequately covered.

Brexit

In the second half of the year, BaFin held many discussions with banks and financial services providers who were considering relocating their activities as broker-dealers to Germany and applying to BaFin for authorisation as securities trading banks, following the referendum in the United Kingdom on leaving the European Union.[57]

2.4.13 Financial services institutions

At the end of 2016, BaFin's Securities Supervision/Asset Management Directorate had 708 financial services institutions under its supervision (previous year: 674). It was also responsible for supervising 94 German branches of foreign institutions (previous year: 86).

32 undertakings applied for authorisation to provide financial services in 2016 (previous year: 25). 8 financial services institutions applied to extend their authorisation to cover the provision of additional financial services (previous year: 13). The number of tied agents at the end of 2016 was approximately 34,900 (previous year: approximately 38,500).

In the course of 2016, BaFin participated in 39 audits at financial services institutions (previous year: 41) and conducted 97 supervisory interviews with institutions (previous year: 135).

Authorisations

A total of 27 authorisations held by financial services institutions ended (previous year: 28), in most cases because they were returned. BaFin revoked one institution's authorisation to provide financial services. At the same time, BaFin required the institution to provide evidence to it within four weeks of the cessation and winding-up of all transactions subject to authorisation. One member of the institution's management board had previously made unauthorised use of his power of disposal over customers' assets entrusted to the institution, and used them for improper financial transactions. In consequence, the institution was faced with substantial claims

57 See 2.4.8. and chapter I 8.

Contingency provisions

The purpose of contingency provisions is to reflect anticipated – but as yet uncertain – liabilities in the financial statements and therefore ensure that the undertaking can continue its business operations in an orderly manner with sufficient capital available. Contingency provisions must therefore be recognised in all cases where utilisation of the provision is to some extent probable or if it can seriously be expected to occur. It forms part of the duties of a prudent businessman not simply to ignore risks of this nature, such as anticipated payments for damages. If any such claim is pending against the undertaking, court rulings indicate that there is an obligation in principle to recognise a provision from the date the action is brought. Exceptions to this are recognised only in narrowly defined cases, such as in the event of an arbitrary or obviously unlawful action.

for damages, which necessitated a massive increase in its reported contingency provisions (see info box).

The institution was not even close to being able to meet the additional capital requirements that would have been necessary to comply with the capital ratios for banking supervisory purposes. After no improvement in the institution's capital adequacy could be discerned, despite repeated requests by BaFin, and given that there was also no prospect of any such improvement in the medium term, BaFin revoked the authorisation.

IV Supervision of insurance undertakings and *Pensionsfonds*

1 Bases of supervision

1.1 Discussion topic: One year of Solvency II in practice

1.1.1 Opinion

Dr Frank Grund on contemporary insurance supervision

It has been a year since Solvency II was introduced, and one thing is clear: the market participants are getting better and better at dealing with the new supervisory system, although they still have more to learn. But in view of the complexity of the new regulatory framework, anything else would be surprising. Insurance Supervision will continue helping to foster understanding of the new system by issuing its own publications on Solvency II.

Dr Frank Grund

is Chief Executive Director of Insurance and Pension Funds Supervision.

The next milestone on the way to the new supervisory world will be the publication of the Solvency and Financial Condition Reports.[1] For the 2016 financial year, the undertakings must publish extensive information on their regulatory capital requirements at the latest 20 weeks after the year-end – and do so in electronic form, and therefore as a rule on their websites.

The public will then be faced with the task of interpreting the information correctly. Analysis of the key indicators will require a differentiated approach, reflecting the particular characteristics of the undertakings and the extent to which they are able to take individual circumstances into account on request when determining these figures – for example using internal models or undertaking-specific parameters in the standard formula. It will take a few years before we have a reasonably complete picture – once corresponding time series are available.

Differing responses and objectives

Solvency II has created a uniform supervisory system across Europe, but the legal frameworks under which insurers operate are a long way from being harmonised – one only has to think of civil law, commercial law or tax law. Finding the right balance between further harmonisation and the recognition of different national realities is a challenging task. BaFin sees this on a daily basis in the course of its work in the various committees of the European Insurance and Occupational Pensions Authority (EIOPA): the individual member states have divergent views on topics such as the ultimate forward rate or dynamic modelling of the volatility adjustment.

In Germany, legislators have already responded to the low interest rate environment with the Life Insurance Reform Act (*Lebensversicherungsreformgesetz* – LVRG). But it can be observed that other member states are pursuing particular macro- or microprudential objectives via Solvency II that Germany, for example, has already addressed in other ways.

We must also not forget that introducing a supervisory system based on market value cannot alter other aspects of the legal and economic environment. Moreover, business will not conform to the new supervisory system from one day to the next. The European legislature has therefore provided for transitional measures, which ensure that Solvency II will have a gradual effect on the capital requirement. In parallel, insurers will be running down the portfolios that they built up before Solvency II came into effect. This will have the effect of softening the impact of Solvency II on the business strategy pursued in the previous era.

Transitional measures for customers

This should also be borne in mind when undertakings are criticised for using the transitional measures. To do so is not necessarily a sign of weakness – it can also be a strategic decision to ensure a smooth transition, for customers as well. For this reason, it is not always advisable to avoid using such measures; if they are not used, the undertaking has to accept the consequences for its own portfolio at the same time: significant increases in capital requirements for business involving long-term guarantees. In combination with the volatility of a market value-based system such as Solvency II, such decisions could result in capital requirements so high that an insurer has to modify its investment strategy to the disadvantage of customers – away from higher-yielding asset classes towards investments that are less risky but also less profitable. For these reasons, one can only warn against stigmatising undertakings that make use of the transitional measures. It might even be a very sensible decision in the interests of the customers.

Principles-based supervision

Solvency II represents a move away from a purely rules-based system to a more principles-based system for insurance supervision. There was initially some uncertainty on the part of the undertakings in dealing with this new

1 See 1.1.1.1.

supervisory approach, which is not surprising, especially as BaFin had to focus first of all on formal topics and on the plausibility checks for quantitative reporting. However, BaFin has provided initial guidance in the form of its interpretative decisions to help the insurers find their bearings[2], for example regarding the groups of issues around deferred taxes and the ORSA.[3] BaFin's next step will be to address the content of the ORSA in greater detail: the ORSA reports received to date show that there is still room for improvement. BaFin will make its position clearer on this subject – as always in the context of a constructive dialogue with the undertakings, of course.

Proportionality

The principle of proportionality allows the undertakings a considerable degree of flexibility in implementing many, though not all, of the requirements. Proportionality does not mean that the insurers do not have to comply with the applicable requirements; it is a question of "how", not "whether". There is in principle no provision for exemption from the requirements. There is one – explicitly stipulated – exception: the quantitative reporting obligations.[4] As a general rule, the undertakings are required in the first instance to comply with this core component of Solvency II and to implement the regulatory requirements in a manner appropriate to the nature, scope and complexity of their risks. The Supervisory Authority will then review whether the implementation is in fact appropriate and require adjustments to be made, where necessary. As far as possible, BaFin will also provide the industry with detailed guidance on the proportional application of Solvency II – as it has done in connection with technical provisions, for example. BaFin already permits the undertakings to use a simplified procedure for the calculation of expected profits included in future premiums (EPIFP)[5] and of the natural disaster risk for comprehensive vehicle insurance.[6] An interpretative decision issued by BaFin also permits the use of specific simplified procedures for assessing the effects of new business on the existing portfolio's future discretionary benefits.[7]

Drivers of the Solvency II ratios

In 2017, BaFin will look more closely at the drivers of the Solvency II ratios. In keeping with forward-looking supervisory practice, it will put a stronger focus on the sensitivity of the SCR ratio[8] to market movements. The main focus will be on the life insurers, since their SCR ratios are highly sensitive to changes in interest rates as a result of their long-term obligations. BaFin's objective is to develop early warning indicators and supervisory tools so that adverse developments can be counteracted at an early stage.

Rather than being the legislator, BaFin applies the laws as the Supervisory Authority. At the same time, however, it is involved in the development of regulation in Germany as well as on a European and global level. For example, this role involves analysing the potential need to adjust the standard formula in the context of the ongoing SCR review. In BaFin's opinion, it would be desirable for the standard formula to be simplified. There is also a need for adjustment from an actuarial point of view, for example with respect to the calibration of the interest rate risk to reflect very low and negative interest rates. It is unlikely that the capital backing for the risks of government bonds will also be looked at once again as part of the SCR review. But the topic should remain on the agenda.

Consumer protection

Important regulatory decisions affecting the future for consumer protection will also be made in the next two years. The new requirements will represent a challenge for the undertakings in the true sense of the word.

2 www.bafin.de/dok/7857536.

3 Own Risk and Solvency Assessment.

4 See 1.1.1.1.

5 www.bafin.de/dok/7850496 (only available in German).

6 www.bafin.de/dok/7850500 (only available in German).

7 www.bafin.de/dok/7850506 (only available in German).

8 SCR stands for Solvency Capital Requirement. On this subject, see 1.1.1.3.

An example is the Insurance Distribution Directive (IDD), which must be transposed into German law by 23 February 2018.[9] Under the IDD, the supervision of distribution activities will start right at the product development stage in future. The intention is to take the needs of consumers into account even when the product is still being developed. Conflicts of interest between intermediaries and consumers should be avoided or at least made transparent. Anyone in breach of the new regulations can expect to feel the effects of significant sanctions. This development should be particularly interesting against the background of digitalisation – insurtech companies will also have to meet these requirements.

Another regulatory project relating to consumer protection is the PRIIPs Regulation, the regulation on key information documents for packaged retail and insurance-based investment products.[10] The PRIIPs Regulation is intended to establish the framework for the new key information document for retail investors, the PRIIPs KID.

As far as products distributed in the German market are concerned, the scope of the regulation is, unfortunately, not absolutely clear. BaFin will therefore publish appropriate interpretative guidance on the subject. BaFin is currently assuming that, in addition to insurance-based investment products, including traditional endowment life insurance, unit-linked life insurance, hybrid products and variable annuities, deferred annuity insurance could also be covered by the definition of insurance-based investment products. A clearer reference to pure investment products in the PRIIPs Regulation would have been preferable, in order to regulate pension products specifically. The Riester contracts provide a precedent, after all.

9 See 1.4.1.

10 See chapter II 1.10.1.

The PRIIPs Regulation will take effect one year later than planned, namely from 1 January 2018. The undertakings are not required to have the European key information document available until then. The application of the regulation was delayed because the European Parliament raised some criticisms regarding the associated Regulatory Technical Standards and these must now be revised. There was also a desire to give the undertakings more time to prepare.

These and other regulatory requirements relating to consumer protection – including those not dealing with insurance supervision – are inspired by the basic idea that the financial market is structured such that consumers are in a weaker position than providers and undertakings. That is undoubtedly true. And yet one should not lose sight of two things: the general concept of the responsible consumer and the appropriateness of each regulation. Consumer protection must not result in patronisation. And if the provision of financial products becomes too expensive or involves unpredictable legal risks, providers may withdraw from the sector. That would be no help to consumers.

Outlook

On a global level, it remains interesting to see whether the International Association of Insurance Supervisors (IAIS) will succeed in agreeing on the main features of an initial global solvency regime.[11] BaFin is arguing for wide-ranging compatibility with Solvency II, but will certainly also have to find a willingness to make compromises.

By the end of 2017, we will perhaps also know more about the future relationship between the European Union and the United Kingdom, and its effects on the insurance industry. 2017 is and will continue to be an exciting year.

11 See 1.2.1.1.

1.1.1.1 HGB and Solvency II: Differences in reporting

One of the general obligations to which insurance undertakings and insurance groups are subject is to report regularly on their economic position – to the public and to the Supervisory Authority. Various statutory requirements specify what has to be reported, as well as when, how often and to whom. In addition, there are rules governing the policies applied for the measurement of assets and liabilities and which data transfer methods should be used.

Until the start of Solvency II on 1 January 2016, the financial supervision of insurance undertakings was based on reporting in accordance with the accounting requirements of the German Commercial Code (*Handelsgesetzbuch* – HGB). Now, the Solvency II measurement system for supervisory purposes applies across Europe to all insurance undertakings concerned. This means that a very wide-ranging and complex reporting system has come into effect, which is consistent and has been designed on a collective basis at European level. Its scope and complexity reflect the fact, among other things, that a variety of countries have contributed their own differing experiences in the past. The standardised electronic reporting procedure enables the information to be submitted to the European Insurance and Occupational Pensions Authority (EIOPA).

Reporting under HGB

In principle, the reporting obligations of the Commercial Code continue to apply to insurance undertakings as well. In accordance with section 341a of the Commercial Code, insurance undertakings are required to prepare annual financial statements and a management report for the previous financial year in the first four months of each financial year, and to submit them to their auditors. These documents must also be published in the Federal Gazette within 15 months.

Reporting to the public must also comply with the Regulation on Insurance Accounting (*Verordnung über die Rechnungslegung von Versicherungsunternehmen*) – in addition to the provisions of the Commercial Code. The regulation is based on section 330 (3) of the Commercial Code, but also contains prescribed formats for the balance sheet and profit and loss account of insurance undertakings as well as particular requirements for the reporting and measurement of individual items in the balance sheet and profit and loss account.

The measurement policies stipulated by the Commerical Code and the Regulation on Insurance Accounting are essentially based on the principles of prudence and the protection of creditors. As a general rule, assets are recognised at no more than their cost, less depreciation and amortisation, and liabilities at their settlement amount. Section 341e of the Commercial Code lays down general accounting principles for insurers' technical provisions.

BaFin's reporting requirements are considerably more detailed. The requirements for the reports on the economic position are mainly contained in the Insurance Reporting Regulation (*Versicherungsberichterstattungs-Verordnung*). However, since that regulation was based on the German Insurance Supervision Act (*Versicherungsaufsichtsgesetz*) that was in force until the end of 2015, it had to be suspended with a view to being re-issued later. This means that any changes for which the need arises in the meantime can be incorporated directly. The relevant amendment is expected in the second quarter of 2017.

Among other things, the draft of the amended Insurance Reporting Regulation contains provisions governing the form and content of the internal report to be submitted to BaFin, as well as the deadline and the number of copies required. The report consists of a balance sheet prepared using a classification designed for supervisory purposes and a statement of profit or loss classified according to lines of business and types of insurance, as well as special explanatory notes. The forms required by the Insurance Reporting

Regulation may be submitted in paper form or electronically.

Reporting under Solvency II

Reporting under Solvency II applies across Europe to all insurers that fall within the scope of the Solvency II Directive. But it does not consist solely of additional reporting requirements; for German undertakings, some have also been removed, such as the quarterly statements as well as notifications and reports on investments and the financial projections. BaFin has published additional information on reporting in its guidance notice on reporting for primary insurers and reinsurers, insurance groups and *Pensionsfonds*.[12]

A delegated act[13] and two implementing technical standards[14] contain the detailed reporting requirements under Solvency II (see Figure 5 "Legal bases under Solvency II" on page 133):

- Delegated Regulation (EU) 2015/35 contains rules for the measurement of positions required to be included in the solvency statement[15], among other things. The principle underlying Solvency II that all assets and liabilities are measured at fair values on a going concern basis is of course applied in this context. Fair value accounting is a significant difference from HGB measurement principles.
- Implementing Regulation (EU) 2015/2450 contains the reporting forms and the accompanying explanatory notes, among other items.
- Implementing Regulation (EU) 2015/2452 is mainly concerned with stipulating the quantitative information required to be included in the Solvency and Financial Condition Report (SFCR) and the form in which it must be presented.

12 www.bafin.de/dok/6917248 (only available in German).

13 Delegated Regulation (EU) 2015/35, OJ EU L 12/1.

14 Implementing Regulation (EU) 2015/2450, OJ EU L 347/1, Implementing Regulation (EU) 2015/2452, OJ EU L 347/1285.

15 The solvency statement consists of a list of assets and liabilities similar to a balance sheet.

Information on Solvency II

BaFin provides links to all legal bases, guidelines and interpretative decisions relating to Solvency II on its homepage.[16]

Two EIOPA guidelines are relevant in addition to these regulations.[17] The requirements for primary insurers and reinsurers under the Solvency II Directive[18] generally also apply analogously at group level (see info box "Information on Solvency II").

Every insurance undertaking falling within the scope of the Solvency II requirements must publish an annual Report on its Solvency and Financial Condition (SFCR), including the related quantitative forms, and make it available to the public. The report must also be submitted to BaFin. In addition, annual and quarterly quantitative reports are provided electronically to BaFin only. Furthermore, a regular supervisory report (RSR) and – following each own risk and solvency assessment (ORSA)[19] – an ORSA supervisory report (OSR) must also be submitted to BaFin every year, or every two or three years as applicable, both also in electronic form.

Until 2019 extended periods for submitting the reports still apply; after that date, the final deadlines stipulated in Article 312 of the Delegated Regulation must be complied with. The undertakings must also observe the formal requirements of the templates referred to in the Insurance Reporting Regulation (*Versicherungs-Meldeverordnung*). If the information to be transmitted electronically does not comply with these requirements, it is rejected by BaFin and treated as not having been submitted as it is important for the Supervisory Authority that

16 www.bafin.de/dok/7857536.

17 Guidelines on reporting and public disclosure and Guidelines on the methods for determining the market shares for reporting.

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

19 See 1.1.1.3.

the undertakings comply with the deadlines and provisions. Moreover, BaFin promptly passes the Solvency II information on to EIOPA, which is not the case for the HGB figures.

In summary, reporting under Solvency II is complex and focuses on essential principles which differ from reporting under HGB, for example fair value accounting. Furthermore, since under Solvency II measurement is based on fair values and the going concern assumption, the undertakings' key indicators are subject to greater fluctuation. Just one year after the introduction of the new Solvency II supervisory regime, its reporting system is still in the initial phase – and will be subject to further development.

1.1.1.2 Claims provisions – New measurement principles under Solvency II

Claims provisions recognised in the HGB financial statements are crucially important for property and casualty insurance undertakings. In accordance with the principle of prudence and pursuant to section 341e (1) of the Commercial Code, they must always be measured in such a way as to make absolutely sure that the insurer can meet its obligations over the long term.

This remains the case under the new Solvency II supervisory system on the basis of section 294 (4) of the Insurance Supervision Act. However, in the Solvency II balance sheet the best estimate is reported for obligations arising from non-life insurance business. This comprises the best estimates for the claims provisions and the newly introduced premium provision, which must be calculated separately. As a result, claims provisions – and also the calculation of a risk margin which must now be performed – are measured on a new basis which differs from the HGB approach.

The best estimate of the claims provisions is the probability-weighted estimate of the future cash flows for a homogeneous risk group (HRG) until the end of the contract. Any implicit or explicit safety loading is not taken into account in recognising economic values. The measurement must be in accordance with market conditions. As a consequence, the estimated claims cash flows must be discounted at the risk-free yield curve taking account of the time value of money (present value approach). As a present value, the best estimate will therefore generally be lower than the HGB value.

The principle of individual measurement that must be observed under the HGB with regard to claims settlement for reserving incurred and reported claims at their fulfilment value continues to apply. However, that does not rule out incorporating the payment-related data for known individual claims under HGB into the best estimate for a homogeneous risk group.

The best estimate of the claims provisions is based on a more future-oriented perspective and accordingly an economic ultimate view: insurers therefore estimate the development of claims, using stochastic reserving methods in some cases, with explicit reference to individual subsequent years up to the ultimate claims expenditure. This requires cash flow projections forecasting the exact amount and timing of future cash flows. Undertakings' internal validation procedures can provide initial methods of assessing these calculations, as well as the robustness and forecasting accuracy of the best estimate. In addition, at least once a year the undertakings analyse the data, assumptions, methods and amounts underlying their best estimates. The standard against which these values are assessed is once again the homogeneous risk group. Instruments used in this internal quality assurance process include backtesting and sensitivity analyses.

1.1.1.3 ORSA in the management of undertaking

With the entry into force of Solvency II, insurance undertakings are required to carry out regular own risk and solvency assessments (ORSAs). The resultant findings must be fed back into the management of the undertaking on a continuous basis. Implementing and making use of the ORSA as an integral component of the risk management

system represents a challenge for the undertakings – not least because of the high degree of freedom in carrying out the ORSA. On 1 January 2016, BaFin summarised its expectations in an interpretative decision on the ORSA.[20]

Provision of cover at all times

Insurance undertakings must ensure that they are always in a position to cover their solvency capital requirement (SCR) and minimum capital requirement (MCR, see info box "SCR and MCR") with eligible own funds. In accordance with section 27 of the Insurance Supervision Act, (ad hoc) ORSAs must therefore be carried out regularly (at least annually) and when there are material changes in the risk profile.

As a component of Pillar II of Solvency II (governance system), the ORSA represents a significant element of the risk management system. If the analysis makes it clear that an undertaking is below its SCR, it must take countermeasures by making appropriate adjustments to its risk profile in good time and/or providing additional eligible own funds.

The central function of the ORSA is therefore to assess whether the regulatory capital requirements are being complied with at all times. Equally important is the forward-looking determination of solvency needs on an economic basis – i.e. independently of the regulatory capital requirements. This determination is based on the undertaking's general planning horizon (normally three to five years) and, in addition to current risks, takes into account risks which may only become clear over the long term. The ORSA also represents a corrective to Pillar I of Solvency II (solvency capital requirement): the variance analysis required to determine the differences between the undertaking's actual risk profile and the assumptions on which the SCR calculation is based serves the purpose of establishing whether the SCR adequately covers all material quantifiable risks. This includes both risks to which the undertaking is already exposed and those to which it could be exposed. If risks have not been taken into account to a material extent, the Supervisory Authority may intervene.

SCR and MCR

The solvency capital requirement (SCR) determines how much capital undertakings must hold 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.

Integration with management processes

Business decisions and external factors may give rise to relevant changes in the risk profile. In consequence, the findings of the ORSA are intended to be fed back into the business and risk strategy and taken into account on an ongoing basis when making strategic decisions. Undertakings must assess the effects on their risk profile and therefore on the regulatory capital requirements and their overall solvency needs prior to taking essential measures. In particular, the findings of the ORSA must be incorporated into business planning and capital management as well as product development. The ORSA process and report in this way contribute to the long-term management of business.

The central responsibility for the ORSA therefore lies with the management board and may not be delegated to individual board members or transferred in its entirety to committees. BaFin expects all members of the management board to have thorough knowledge of the risk profile and the resulting

20 www.bafin.de/dok/7499552 (only available in German).

capital needs – if not in the same degree of detail. A general understanding of the SCR calculation is also a requirement. On this basis, the management board must actively control the ORSA process, discuss the undertaking's risks and capital needs and inform BaFin of the findings and conclusions of the ORSA by submitting the corresponding report.

Supervisory practice

In view of the outstanding importance of the ORSA, BaFin paid particularly close attention to its implementation even in the preparatory phase. However, a varied picture emerges from the first year of application of Solvency II as far as dealing with the ORSA is concerned. For some undertakings it presents major challenges (see info box "Insurance Supervision Annual Conference"). In keeping with the principle of proportionality, every insurance undertaking must establish appropriate, individual ORSA processes and draw up a corresponding ORSA report. Certain minimum requirements can be reflected in the ORSA relatively easily. These include, for example, the performance of stress tests and scenario analyses as well as scrutiny of the SCR calculation. The assessment of whether such requirements have been adequately met is also straightforward.

On the other hand, it is considerably more demanding for undertakings to put into practice two of the fundamental principles of the ORSA: the multi-annual perspective and – related to that – the use of the ORSA for the management of the undertaking.

Multi-annual perspective

The responsible persons for the ORSA in the insurance undertakings sometimes take a sceptical view of the multi-annual perspective required. A forward-looking assessment ties up resources and forecasts are always subject to uncertainty. The assessment of those forecasts and the preparation of detailed documentation – so that they can be understood by knowledgeable third parties – represents a challenge. A further factor is likely to be concern on the part of the responsible persons that they may be criticised at a later date if the estimations turn out to be wrong. BaFin pays careful attention to the appropriateness of the assessment of future risk-bearing capacity and to the conclusions derived from it, which then form the basis for the undertaking's strategic decisions.

Use for the management of the undertaking

The ORSA is not intended to be an unavoidable obligation imposed by BaFin but should be

Insurance Supervision annual conference

On 26 October 2016, around 250 representatives of insurance undertakings and industry associations met in Bonn to report on their initial experiences with Solvency II at the traditional annual conference of the Insurance Supervision Directorate. "The industry has successfully arrived in the new supervisory regime", was the positive interim conclusion of Dr Frank Grund, Chief Executive Director of Insurance and Pension Funds Supervision. He also commented, however, that the learning process was far from over. Guest speaker Ulrich Leitermann, Chairman of the Board of the SIGNAL IDUNA Group, praised the constructive cooperation between the industry and the Supervisory Authority. In his speech, Gabriel Bernardino, Chairman of the European Insurance and Occupational Pensions Authority (EIOPA), reflected on the idea of Europe and, in connection with this, a shared understanding of laws and supervisory objectives. Guaranteeing the implementation of EU regulations, establishing a level playing field and similar consumer protection standards in all EU member states are essential objectives, he said. The programme of events was rounded off with panel discussions on insurers' investment behaviour under Solvency II and the impact of the new supervisory arrangements on consumer protection and insurance distribution.

used – as described above – for the management of the undertaking. The undertakings are continuing to work on implementing appropriate ORSA processes and are integrating the risk management procedures they established under Solvency I with the ORSA. The communication of the ORSA findings to relevant units within the undertakings so that they can be taken into account in essential management decisions is also developing further.

The same applies to the performance of ORSAs in preparation for strategic decisions. Ad hoc ORSAs of this kind should be carried out, for example, prior to an intended portfolio transfer – at least in cases where this is expected to have a significant effect on the undertaking's risk profile and therefore its long-term risk-bearing capacity. At the same time, the definition of sufficiently specific events triggering the need for an ad hoc ORSA in the undertakings' own ORSA guidelines may sometimes conflict with their desired degree of freedom in carrying out ORSAs.

Outlook

The ORSA is an essential instrument providing undertakings and the Supervisory Authority with a comprehensive overview of current and future risks and the related capital requirements. The findings of the ORSA are increasingly being used as the basis for strategic management decisions. BaFin will continue its dialogue with insurance undertakings for the purpose of further developing the ORSA.

1.1.2 Changes in the legal framework

1.1.2.1 Amendment of Delegated Regulation (EU) 2015/35

In November 2014 the European Commission launched an Investment Plan for Europe. The objective of the plan is to facilitate investments in infrastructure by insurers, which are large institutional investors. A new asset class for infrastructure investments with reduced capital requirements was to be established for this purpose under the framework of the new Solvency II supervisory regime. This required changes to be made to the Delegated Regulation[21] (see Figure 5 "Legal bases under Solvency II").

The European Commission issued a corresponding amending regulation[22] on 1 April 2016. The Commission had sent a call for advice to EIOPA in February 2015. A particular focus of the amended regulation was on building a more interconnected single

Figure 5 Legal bases under Solvency II

21 Delegated Regulation (EU) 2015/35.

22 Delegated Regulation (EU) 2016/467, OJ EU L 85/6.

market. In addition, the new asset class was not to be limited to specific sectors or physical structures, but should include all systems and networks that provide and support essential public services.

The amending regulation also corrects editorial errors in the original Delegated Regulation. Furthermore, it contains requirements for adjusting the reporting templates to include information on infrastructure investments. Following public consultation, the Commission published a corresponding amending regulation for this purpose in the Official Journal of the European Union on 21 October 2016.[23]

1.1.2.2 Review of the Solvency II standard formula

In mid-July 2016 the European Commission presented a call for advice in which it explains its plans for the review of the standard formula under Solvency II. The Commission's call for advice is essentially based on recital 150 in the Delegated Regulation and on an earlier call for evidence[24] issued by the Commission, which gave the European insurance industry the opportunity to present reasoned criticisms and suggestions for improving the standard formula to the Commission.

The consultation on the call for advice began in December 2016 and ended in March 2017. The Commission is expected to complete its review of the standard formula during 2018.

In BaFin's view, the following topics in the discussion paper are particularly significant for the German market in the first instance:

- Review of the interest rate risk module
- Simplifications of a general nature
- Simplifications in specific risk modules (in particular counterparty default risk, catastrophe risk module, non-life lapse risk)
- Review and potential recalibration of risk factors in the premium and reserve risk module
- Potential expansion of the scope for undertaking-specific parameters
- Review of the catastrophe risk module (in particular in relation to man-made catastrophe risks)
- Review/recalibration of the volume measure for premium risk in the premium and reserve risk module

As far as possible, data from the quantitative reporting templates (QRTs) were used for the purpose of reviewing the standard formula, in order to keep the additional expense for national supervisors and in particular for the undertakings as low as possible. Nevertheless, EIOPA required additional information from the (re)insurance undertakings for a small number of analyses and potential recalibrations. BaFin requested this information from all undertakings falling within the scope of Solvency II. The undertakings were allowed time until 29 March 2017 to submit the information to BaFin.

The undertakings were not legally obliged to participate in this data collection exercise, but it was in the interests of the German insurance industry. The data of the German (re)insurers enables their risk profile to be more fully reflected in the European standard formula. BaFin therefore advised the undertakings to participate.

1.1.2.3 Revision of the methodology for determining the ultimate forward rate

Since the entry into force of Solvency II, all (re)insurers have measured their technical provisions using a standard, risk-free yield curve, calculated by EIOPA and issued by the European Commission. The yield curve is based on market data for swap and bond interest rates. Interest rates for maturities for which reliable market data are no longer available are determined by extrapolation, based on a long-term forward interest rate, the ultimate forward rate (UFR).

23 Implementing Regulation (EU) 2016/1868, OJ EU L 286/35.

24 http://ec.europa.eu/finance/consultations/2015/financial-regulatory-framework-review/index_en.htm.

In March 2015, EIOPA decided to revise the methodology for determining the UFR. The main point of criticism was that the raw data and the details of the methodology were private and not available under licence. EIOPA's announcement of its work on the UFR came immediately after the introduction of monthly publication of the risk-free yield curves.

Following the first consultation in summer 2015, EIOPA redefined the methodology. This is based on data published by the Commission (annual macro-economic database – AMECO) and the Organisation for Economic Co-operation and Development (OECD). The new methodology envisages a UFR made up of the inflation target of the relevant central bank and an average value based on historical data for real interest rates. It delivers UFR values which are lower than the values produced by the old methodology. A consultation exercise for the proposed UFR methodology was carried out from April to July 2016.

The main criticism reflected in the comments on the consultation was that the UFR lacked the stability required by Article 47 of Delegated Regulation 2015/35.

At the end of March 2017, the Board of Supervisors of EIOPA agreed on a compromise for the new methodology, intended to balance out the interests of the different countries. A number of stabilising elements were incorporated into the draft submitted for consultation.

The new methodology is expected to be used for calculating the risk-free yield curve from 2018 onward. The European Commission can then declare the yield curve calculated by EIOPA to be legally binding by adopting an implementing act.

1.2 New developments at international level

1.2.1 Global framework

1.2.1.1 Global capital standards

In 2016 the International Association of Insurance Supervisors (IAIS) vigorously pursued its objective of developing a global risk-based capital standard for large internationally active insurance groups (IAIGs) for the first time by 2020.

A consultation paper emerged from these endeavours and was published on 19 July 2016, laying the foundation for the initial version of a risk-sensitive capital standard (Insurance Capital Standard – ICS 1.0). For the subsequent years until 2020, this capital standard is intended to form the basis for the expanded field test, among other things. The wide-ranging feedback from interested parties across the globe is being incorporated into the continuing deliberations on ICS 1.0. The IAIS is aiming to complete the standard in the summer of 2017.

The work will also take on board the results of the IAIS field test in which more than 40 insurance undertakings are currently taking part voluntarily. They will contribute to the development of a comparable global capital standard and to the appropriate calibration of the capital requirement. However, both 2017 and 2020 can only be the initial stages on the journey to the ultimate goal: global comparability of the capital requirements and own funds of IAIGs.

The discussions are therefore focusing not just on measuring and discounting assets and liabilities in the most similar manner possible, but also on the question of how own funds can be determined using consistent criteria and how

the risk capital requirement can be defined. This involves taking into account both technical risks and other risks to which an insurance undertaking can be exposed, such as market risks.

Widely differing capital standards are in place across the globe today which all have the same objective in principle, namely the protection of the policyholder, but they are trying to achieve this using different approaches. Developing a uniform standard is therefore a challenging undertaking.

The planned ICS is being designed as the minimum standard for a solvency requirement. The IAIS members are therefore free to exceed it for the purposes of national implementation. BaFin is working together with its European colleagues to ensure that the ICS reflects the Solvency II requirements as closely as possible, so that ultimately Solvency II can be regarded as implementing the ICS.

The IAIS is not currently not continuing with the revision of the higher loss absorbency requirements (HLA) for global systemically important insurers (G-SIIs), the first version of which was published at the end of 2015, since ICS 1.0 has priority. Only when the latter has been finalised will the IAIS resume work on the HLA alongside ICS 2.0, not least because the ICS is also intended to form the basis for calculating the HLA in the long term.

1.2.1.2 Identification of G-SIIs

The Financial Stability Board (FSB) published its annual update of the list of global systemically important insurers (G-SIIs) on 21 November 2016.[25]

It followed an intensive analytical process which involved a large number of supervisors from different countries in the IAIS committees. After G-SIIs were identified for the first time in 2013 on the basis of a new methodology[26], the IAIS collected participants' experiences in the subsequent years and used them to revise the identification methodology. The IAIS published the new methodology on 16 June 2016.[27]

The IAIS members had agreed to introduce a five-stage procedure focusing on individual groups, the entity-based assessment (EBA), which was used for the first time in 2016. As part of this procedure, a central quantitative scoring based on data requested from a sample of around 50 insurance undertakings (Phase I), applies absolute reference values (ARVs) for three of 17 indicators used by the identification methodology (Phase II). This enables the IAIS to reflect the fact that for individual activities of the undertakings included in the sample, the sample may not be representative of the market as a whole or that an activity may have become materially less significant since the financial crisis. During the procedure the IAIS constantly reviews the possible need to revise other indicators as well. For a subsection of the sample, i.e. undertakings with a points score above an annually specified threshold, it also carries out a deeper analysis to take account of additional factors which may be only inadequately reflected in the indicators employed (Phase III). This emphasises the fact that the identification of G-SIIs goes beyond the use of a mere algorithm and that the IAIS is analysing the respective results in a broader context than previously. Another improvement worthy of particular mention is that the new procedure enables the insurance groups concerned to be involved in their assessments at an earlier stage by means of an intensive exchange of information and opinions (Phase IV), i.e. before the IAIS makes a recommendation to the FSB based on an overall review of all the findings from the different phases (Phase V). The IAIS has also undertaken to publish material items of information resulting from the process, once the FSB has made a designation.

The IAIS is aiming to complete a further revision of the methodology for identifying G-SIIs in 2019.

25 http://www.fsb.org/2016/11/2016-list-of-global-systemically-important-insurers-g-siis.

26 See 1.2.1.3 for more on this subject.

27 See 2015 Annual Report, pages 170 ff.

1.2.1.3 Activity-based assessment

The IAIS has also launched a new project concerned with a methodology for identifying systemic risks based on activities (activity-based assessment – ABA) rather than on individual undertakings. This addresses the question of what other aspects of systemic importance exist that were previously not included in the identification of G-SIIs.

Direct systemic risk

Background: in the wake of the financial crisis, the FSB had entrusted the IAIS with the task of identifying systemically important insurers and developing a methodology for this purpose, as in the banking sector. An approach of this kind focuses on direct systemic risk, i.e. the risk posed by an individual insurer or an individual insurance group which may have consequences for the entire financial system.

The risk may be caused by the activities of the undertaking or the features of its products. Depending on the size and degree of interconnectedness of an insurer, it may directly trigger disruptions affecting the whole system. A direct systemic risk therefore generates a first-round effect: the insurance undertaking itself exposes the entire system to a direct systemic threat.

Indirect systemic risk

A direct systemic risk of this kind must be distinguished from an indirect systemic risk. An indirect systemic risk refers to the potential negative consequences for the whole financial system triggered by the activities of one or more insurers that react simultaneously to negative external events or shocks to which they were exposed. In the case of an indirect systemic risk, a second-round effect arises: systemic consequences for the entire global system arise only when the activities or reactions of a number of insurers to negative events or shocks are combined.[28]

28 On the subject of direct and indirect systemic risk, see Felix Hufeld, "A Regulatory Framework for Systemic Risk in the Insurance Sector"; in: "The Economics, Regulation and Systemic Risk of Insurance Markets", ed. by Felix Hufeld, Ralph S.J. Koijen, Christian Thimann, Oxford, 2017.

ABA for indirect systemic risks

While the IAIS has been monitoring direct systemic risks since 2013 by means of G-SII designation, it is now also turning its attention to indirect systemic risks by applying the ABA approach. Work on the ABA has only just started and represents a project for the longer term.

One of the issues to be addressed is the identification of activities that could generate second-round effects in the event of a collective response. The IAIS has a wide range of preparatory work to turn to for this purpose, including knowledge gained from the G-SII process to date. The EBA takes individual activities into consideration as well. It also would seem appropriate to design an ABA as a supplement to an EBA, so that a hybrid overall approach covering all aspects of systemic risk is available for the insurance sector.

Regulatory policy measures

A final, but decisive, element for containing systemic risks is the establishment of regulatory policy measures, including the higher loss absorbency capacity (HLA) of G-SIIs.

Consideration must be given to whether the Supervisory Authority already has sufficient instruments with respect to indirect systemic risks or whether special tools are required. The focus continues to be the protection of policyholders – and the laws currently in force already provide a wide range of effective instruments which, at the same time, contribute to financial stability.

In view of the complexity of indirect systemic risks and their interaction with direct systemic risks, supervisors must carefully analyse the relevant activities and possible regulatory policy measures. Changes or additional measures should therefore not be expected in the short term.

1.2.2 European framework

1.2.2.1 Pan-European pension products

During the course of 2017, the EU Commission is planning to put forward a proposal for a

simple, effective and competitive EU product for private pension provision – a Pan-European personal pension product (PEPP). This idea is also reflected in the European Commission's Green Paper on a Capital Markets Union[29] . The Commission's objective is to encourage EU citizens to increase their savings for private pensions. It also sees this as a method of strengthening the single market, since capital employed for the purpose of private pension provision can itself contribute in turn to the financing of the economy.

The Commission issued a call for advice to EIOPA for this reason in 2014. The paper which EIOPA then prepared and completed in mid-2016[30] contains the first specific proposals for the possible structure of a PEPP. The European Commission then conducted a public consultation exercise on an EU legal framework for private pensions. The consultation concluded in October 2016. In parallel, the Commission held a public hearing on a possible pan-European pension product. The Commission's initiative met with great approval throughout the hearing.

According to the current plan, a European product of this nature would stand alongside the existing systems of old-age provision and would be defined by a regulation at EU level.

The detailed specification of the requirements represents a challenge: they must be formulated in such a way that the product is admissible as a pensions product in all member states and is also approved as such. Approval could be important, for example, if it is intended to allow holders the opportunity to benefit from tax advantages. It must also be ensured that there is no blurring of the dividing line between pension products (long-term investment with the aim of generating an income for the client in old age) and pure investment products (focused exclusively on returns). In BaFin's opinion, a clear distinction must continue to be evident in this respect.

1.3 Occupational retirement provision

1.3.1 IORP II Directive

The directive on the activities and supervision of institutions for occupational retirement provision (IORP II Directive) came into effect on 13 January 2017.[31] It replaces the existing IORP Directive and must be transposed into national law within two years.[32]

The principal regulations and amendments contained in the IORP II Directive – as compared with the existing directive – are as follows:

- The scope of the directive remains unchanged. In particular, pension provisions and support relief funds (*Unterstützungskassen*) are not covered by the directive, as before.
- The IORP II Directive now also contains regulations on cross-border portfolio transfers. In addition, the deadline for communicating the relevant requirements of social and labour law in the case of cross-border activities is reduced from two months to six weeks. Moreover, the member state in which the institution carries out cross-border activities may no longer lay down investment rules for cross-border IORPs operating in its country.
- The existing quantitative regulations on technical provisions and own funds are largely retained.
- In contrast, the IORP II Directive expands the qualitative requirements significantly. For example, in future undertakings must have key functions in place (risk management function, internal audit function and, where applicable, an actuarial function) and carry out an own risk assessment (ORA).

29 On the capital markets union, see also chapter I 2.1.2 and chapter II 6.1.

30 Consultation paper on EIOPA's advice on the development of an EU Single Market for personal pension products (PPP); available at https://eiopa.europa.eu.

31 Directive (EU) 2016/2341, OJ EU L 354/37.

32 Directive 2003/41/EC, OJ EU L 235/10.

- With respect to investment rules, member states will continue to have the option to prescribe quantitative requirements. However, the prescribed investment limit for shares may not be lower than 35 %.
- The IORP II Directive adds considerably to the obligations to provide information to members, beneficiaries and also potential members. For example, a pension benefit statement with standard minimum contents will have to be provided in future. Undertakings must also inform members and beneficiaries if they have issued a guarantee and if reductions in benefits are possible.
- The Solvency II Directive[33] will also be amended as a result of the IORP II Directive. The definition of "reinsurance" is being changed to include the provision of cover by a reinsurance undertaking to an institution that falls within the scope of the IORP II Directive.

1.4 Insurance distribution

1.4.1 Implementation of the Insurance Distribution Directive

The transposition of the Insurance Distribution Directive (IDD)[34] into German law was an important topic for BaFin in 2016. The directive is not required to be transposed into national law until 23 February 2018. However, an initial ministerial draft by the Federal Ministry for Economic Affairs and Energy (*Bundesministerium für Wirtschaft und Energie* – BMWi) was published on 22 November 2016; the government draft followed on 18 January 2017.[35] BaFin was involved in restructuring the existing national regulations together with the Federal Ministry of Finance (*Bundesministerium der Finanzen* – BMF) and was mainly concerned with requirements relating to the Insurance Supervision Act.

Manageable level of existing regulation

The new regulations on insurance distribution, and therefore the planned German implementation of the directive as well, will significantly alter the supervision of distribution-related activities. Under the provisions of the old directive on insurance mediation[36] – currently still in force – the supervision of insurance distribution is based on the concept that it is sufficient to ensure the fitness and propriety of an intermediary in terms of commercial law. For this purpose, insurance undertakings are required to address distribution-related issues in particular in the context of risk management. This abbreviated summary makes it clear that, at the moment, the level of supervisory regulation is still manageable.

Changes due to the IDD

This will change with the implementation of the IDD. For example, the supervision of insurance undertakings is intended to start in future at the earlier stage of the product development processes. It will also be expected to ensure that conflicts of interest in distribution, i.e. between customers and undertakings, are avoided. Even if these points only represent small extracts from the regulatory framework, it is already clear at this point that the IDD will entail the implementation of a systemic change.

However, the new directive leaves scope for interpretation, since it makes use of indefinite legal concepts. According to the discussions on the implementation of the directive in Germany to date, this scope is expected to remain in place. As the supervisory authority, BaFin will therefore have to address in future the issue of what constitutes "appropriate" measures for the purpose of preventing conflicts of interest between intermediaries and customers, or what represents "adequate" remuneration for distribution.

The government draft also contains provisions tailored to the German market which do not

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

34 Directive (EU) 2016/97 of the European Parliament and of the Council of 20 January 2016 on insurance distribution (recast).

35 Bundesrat printed paper 74/17 dated 27 January 2017.

36 Directive (EU) 2002/92/EC, OJ EU L 9/3.

derive from the Directive. These include, for example, the rules relating to the ban on special remunerations and therefore in particular to the ban on the sharing of commissions, as well as provisions applying to insurance consultants.

Delegated acts relating to the IDD

There will be further European regulations in the form of delegated acts, presumably in 2017, that will implement additional detailed provisions relating to the directive on insurance distribution. This project will run in parallel to transposition into national law.

The EU Commission instructed EIOPA to draw up proposals for the delegated acts provided for by the IDD by 1 February 2017. EIOPA consulted interested parties on the drafts of these proposals from July to October 2016. A public hearing on the subject took place in Frankfurt am Main on 23 September 2016.

The content of EIOPA's proposals focuses on the following four topics:

- Product oversight and governance requirements for all types of insurance products (Article 25(2) of the IDD)
- Conflicts of interest relating to insurance-based investment products (Article 27f(4) of the IDD)
- Commissions/inducements relating to insurance-based investment products (Article 29(4) of the IDD)
- Assessment of suitability and appropriateness and reporting obligations relating to insurance-based investment products (Article 30(6) of the IDD)

59 responses to the consultation were received, of which 17 were from Germany. EIOPA has reacted to many of the criticisms by amending its proposals. The revised EIOPA proposals were submitted to the EU Commission on 1 February 2017. It remains to be seen to what extent the EU Commission takes the proposals into account for its delegated acts, since it is not obliged to do so.

1.4.2 Claims settlement by insurance brokers

By a judgment dated 14 January 2016, the Federal Court of Justice (*Bundesgerichtshof* – BGH) ruled that insurance brokers are in breach of the Legal Services Act (*Rechtsdienstleistungsgesetz*) if they settle claims on behalf of an insurer.[37]

For example, an insurance broker which had arranged a liability insurance contract for a textiles cleaning company settled a claim for the injured customer on behalf of the insurer.

In its judgment, the BGH made it clear that the settlement of insurance claims constituted a legal service within the meaning of the Legal Services Act. It stated that the settlement of claims on behalf of an insurance undertaking did not generally form part of the professional profile or activities of an insurance broker – not even as an ancillary service. In accordance with section 5 (1) of the Legal Services Act it was therefore not permitted.

The assumption that this was a permitted legal service also conflicted with section 4 of the Legal Services Act. Pursuant to that section, legal services which could directly affect the performance of another service obligation may not be provided if doing so would endanger the proper execution of the other legal service. This provision is intended to avoid conflicts of interest.

Brokers acting in the interests of the policyholder

The BGH explained that insurance brokers acting in the interests of the policyholder were under an obligation to take these interests into account even when performing a legal service for the insurance undertaking. That was precisely what could endanger the proper provision of the legal service with respect to the insurance undertaking.

The insurance brokers' economic interest in settling claims for a particular insurance

37 Case ref. I ZR 107/14. See also BaFin Journal February 2017, page 19 ff. (only available in German).

undertaking would frequently be greater than their economic interest arising from their relationship with an individual insurance customer whose contract they had previously arranged in return for a commission. In these circumstances, insurance brokers would have an incentive to represent the interests of the policyholder – which was their professional obligation – only in a restrained way. Section 4 of the Legal Services Act was intended to guard against influences of this kind.

In principle, the BGH does not rule out that in particular areas other than textiles liability insurance the insurance broker's activity profile has changed, or could change in future, to include the claims settlement for insurance undertakings. However, section 4 of the Legal Services Act would also apply in this event, and the settlement of claims would generally not be permitted anyway as a result of the conflict of interests described.

From the perspective of insurance supervisory law, this affects the insurance undertakings' compliance with statutory requirements in particular. They will have to modify the way in which they work together with brokers to reflect the provisions of the judgment.

1.5 Regulations

1.5.1 Audit Report Regulation

In August 2016 the new Audit Report Regulation (*Prüfungsberichtsverordnung*) was available for public consultation. It will replace the 1998 regulation that was in force until 31 March 2016, and be applicable for the first time to the audit of financial years beginning after 31 December 2015. For BaFin, audit reports are a crucial source of information on the business situation of the undertakings under supervision. The Audit Report Regulation sets out in detail the Supervisory Authority's requirements for the contents of the audit reports as well as the nature and scope of the reporting.

The German Act to Modernise Financial Supervision of Insurance Undertakings (*Gesetz zur Modernisierung der Finanzaufsicht über Versicherungen*) came into effect in full on 1 January 2016.[38] It amends the Insurance Supervision Act and transposes the Solvency II Directive into German law.[39] Among other things, the Insurance Supervision Act provides in section 35 that the solvency statement undertakings are required to submit must be audited and reported on by an auditor. In the solvency statement, insurance undertakings subject to the Solvency II supervisory requirements list their assets and liabilities in accordance with supervisory recognition and measurement principles that are different from those applying under commercial law.

The solvency statement forms the basis for calculating the supervisory capital requirements and own funds, and is therefore critically important for the Supervisory Authority. It must also be published by the insurance undertakings under the new disclosure requirements.

The previous version of the Audit Report Regulation has subsequently been expanded for the future to include more detailed regulations governing the scope of the auditor's reporting obligations. There are additional new reporting obligations regarding supervisory requirements. They relate to compliance with orders issued by BaFin in accordance with section 4 (1) sentence 3 of the German Securities Trading Act (*Wertpapierhandelsgesetz*), compliance with obligations arising from derivatives transactions and for central counterparties and also the use of ratings.

1.5.2 Expertise for the granting of consumer loans for immovable property

Legislators have revised a large number of regulations relating to consumer loans in the form of the Act Implementing the Mortgage Credit Directive and Amending the Provisions

38 Federal Law Gazette I 2015, page 434.

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

of Commercial Law.[40] Of particular importance for the insurance industry is the newly added section 15a (1) of the Insurance Supervision Act which refers to section 18a (6) of the German Banking Act (*Kreditwesengesetz*). Under section 18a (6) of the Banking Act, persons engaged in the granting of consumer loans for immovable property must have appropriate specialist knowledge and abilities and keep them up-to-date.

The Federal Ministry of Finance has issued a regulation on the requirements relating to the expertise of internal and external staff of insurance undertakings and *Pensionsfonds* engaged in granting consumer loans for immovable property (*Verordnung über die Anforderungen an die Sachkunde der mit der Vergabe von Immobiliar-Verbraucherdarlehen befassten internen und externen Mitarbeiter von Versicherungsunternehmen und Pensionsfonds*) in order to specify the requirements in detail.[41] The regulation is based on the authorisation to issue regulations contained in section 15a (2) of the Insurance Supervision Act and entered into force on 7 December 2016. It represents the counterpart to the regulation on the requirements for the expertise of internal and external staff engaged in granting consumer loans for immovable property applying to banks (*Immobiliar-Darlehensvergabe-Sachkunde-Verordnung*).[42]

1.6 BaFin circulars

1.6.1 Minimum requirements for the governance of insurance undertakings (MaGo)

The Insurance Supervision Act, which – as described above – was amended by the German Act to Modernise the Financial Supervision of Insurance Undertakings (*Gesetz zur Modernisierung der Finanzaufsicht über Versicherungen*) at the start of 2016, contains numerous provisions relating to the governance of insurance undertakings. A delegated act of the European Commission contains additional directly applicable stipulations.[43] BaFin applies the EIOPA guidelines on the system of governance[44] for the purpose of interpreting the provisions on governance – except where it has stated that individual guidelines will not be applied in full.

BaFin had already published many of these requirements in 2014 and 2015 in order to prepare the undertakings for Solvency II. With the commencement of the new supervisory regime, it revised and updated the published requirements and carried them over into interpretative decisions. In the next step, BaFin summarised and further developed the minimum requirements from the interpretative decisions in a circular on the minimum requirements for the governance of insurance undertakings (*Mindestanforderungen an die Geschäftsorganisation von Versicherungsunternehmen*), which was published in January 2017.[45]

BaFin discussed the first draft of the MaGo with representatives of the industry associations in workshops in July and August 2016. It then revised the draft and made it available for public consultation until November 2016.

The circular is aimed at all undertakings falling within the scope of Solvency II. From the perspective of the supervisory system, it will replace the withdrawn circular 3/2009[46] (MaRisk VA) and stand alongside the Minimum Requirements for Risk Management for banks and financial services institutions (*Mindestanforderungen an das*

40 Federal Law Gazette I No. 12, page 396. On the implementation of the Mortgage Credit Directive, see also chapter II 1.7.

41 Federal Law Gazette I No. 57, page 2765.

42 Federal Law Gazette I No. 20, page 972.

43 Delegated Regulation (EU) 2015/35, OJ EU L 12/1.

44 EIOPA-BoS-14/253 EN.

45 www.bafin.de/dok/8834644 (only available in German).

46 Circular 3/2009 (VA), Minimum Requirements for Risk Management (*Mindestanforderungen an das Risikomanagement* - MaRisk VA) (only available in German).

Risikomanagement – MaRisk BA) and the Minimum Requirements for the Compliance Function *(Mindestanforderungen an die Compliance-Funktion* – MaComp).

In the MaGo, BaFin brings together overarching aspects of governance and gives details of central concepts such as proportionality, administrative, management or supervisory bodies and significant risks. The circular incorporates the initial feedback from the workshops, the public consultation and supervisory practice under Solvency II.

1.6.2 Guarantee assets (*Sicherungsvermögen*)

BaFin revised its circular on guarantee assets[47] in 2016 since, with the entry into force of the new Insurance Supervision Act, the investment rules have also changed. The Insurance Supervision Act now distinguishes between Solvency I and Solvency II undertakings and lays down different requirements for the investment of the guarantee assets. In future, there will therefore also be two separate circulars on the guarantee assets for Solvency I and Solvency II undertakings (see info box "Solvency I or II?"). Both circulars are expected to come into effect on 1 January 2018 and will replace the predecessor circular.

Guarantee assets circular for Solvency I undertakings

On 1 December 2016, BaFin published the guarantee assets circular for Solvency I undertakings.[48] It is aimed at all undertakings authorised to engage in primary insurance business which are subject to the provisions for small insurance undertakings pursuant to sections 212 to 217 of the Insurance Supervision Act, as well as at German *Pensionskassen* and *Pensionsfonds*.

The circular provides Solvency I undertakings with instructions on how to maintain the guarantee assets register and contains minor substantive changes compared with the predecessor circular. It also refers to the amended Insurance Supervision Act as well as to the Investment Regulation for Solvency I undertakings and to the Regulation on the Supervision of *Pensionsfonds* (*Pensionsfonds-*

Solvency I or II?

As at 31 December 2016, 340 insurance undertakings fell within the scope of the Solvency II Directive.[49] Of the total number, 330 were subject to federal supervision and ten to supervision at state level. 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* as amended),
- funeral expenses funds pursuant to section 218 of the Insurance Supervision Act as amended,
- institutions for occupational retirement provision (*Pensionskassen* pursuant to section 232 of the Insurance Supervision Act as amended and *Pensionsfonds* pursuant to section 236 of the Insurance Supervision Act as amended),
- guarantee funds in accordance with section 223 of the Insurance Supervision Act as amended,
- public-law insurers of the public service or of the churches, engaged solely in provision of retirement, invalidity or surviving dependants' benefits (section 2 of the Insurance Supervision Act as amended),
- agricultural liability insurers in accordance with section 140 (1) of the Seventh Book of the Social Security Code (*Sozialgesetzbuch*).

47 Circular 12/2005 (VA), www.bafin.de/dok/2677562 (only available in German).

48 Circular 7/2016 (VA), www.bafin.de/dok/8623674 (only available in German).

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

Aufsichtsverordnung), which have been in force since 22 April 2016.

Draft guarantee assets circular for Solvency II undertakings

In December 2016, BaFin conducted a public consultation exercise on the draft of the guarantee assets circular for Solvency II undertakings.[50]

The draft circular addresses all authorised primary insurers situated in Germany, which are not *Pensionskassen* or undertakings to which the rules for small insurance undertakings pursuant to sections 212 to 217 of the Insurance Supervision Act apply. It is also directed at all authorised primary insurance undertakings and institutions for occupational retirement provision situated outside the signatory states to the Agreement on the European Economic Area (EEA).

The provisions in the draft circular are based on the prudent person principle in accordance with section 124 (1) of the Insurance Supervision Act, according to which Solvency II undertakings must invest their guarantee assets. BaFin has therefore deleted all of the restrictions on the investment of guarantee assets that were based on the Investment Regulation. In addition, the structure of the revised register forms will in future reflect the asset-side balance sheet items in Form 1 of the Regulation on Insurance Accounting (*Verordnung über die Rechnungslegung von Versicherungsunternehmen*).

The circular will be published shortly.

1.7 Interpretative decisions

1.7.1 Annual statement: reporting of the policyholders' share of the valuation reserves

In the case of insurance contracts with discretionary benefits, the insurer is required to inform the policyholders of the performance of their entitlements, including the discretionary benefits, annually in text form, in accordance with section 155 of the German Insurance Contract Act (*Versicherungsvertragsgesetz*) in conjunction with section 6 (1) no. 3 of the Regulation on Information Obligations for Insurance Contracts (*VVG-Informationspflichtenverordnung*). BaFin had noticed that some life insurers are only reporting a guaranteed minimum level of participation in the valuation reserves, also known as the base amount or minimum threshold, in this annual communication – frequently referred to as the annual statement. In BaFin's view, this does not comply with the requirements of section 155 of the Insurance Contract Act in conjunction with section 6 (1) no. 3 of the Regulation on Information Obligations for Insurance Contracts.

BaFin therefore published an interpretative decision on 10 June 2016.[51] This makes it clear that, in the case of life insurance policies entitled to discretionary benefits, the full extent of the policyholders' share of the valuation reserves which is calculated to be attributable to the relevant insurance contract in accordance with section 153 (1) and (3) of the Insurance Contract Act, must be reported in the annual communication.

1.7.2 Reinsurance business of insurance undertakings situated in a third country

The German Act to Modernise the Financial Supervision of Insurance Undertakings (*Gesetz zur Modernisierung der Finanzaufsicht über Versicherungen*)[52] also changed the legal basis for the conduct of reinsurance business by insurance undertakings situated in a third country. Undertakings from a country that is not a member of the EU or an EEA signatory state must hold an authorisation and establish a branch in Germany if they want to carry on reinsurance business in Germany. The first half sentence of section 67 (1) sentence 2 of the Insurance Supervision Act provides

50 www.bafin.de/dok/8661842 (only available in German).

51 www.bafin.de/dok/7983214 (only available in German).

52 Federal Law Gazette I 2015, page 434.

an exemption. According to this exemption, authorisation is not necessary if the third country insurance undertaking conducts only reinsurance business in Germany through provision of cross-border services and if the European Commission has given a positive decision on the equivalence of the solvency system for reinsurance activities of undertakings in that third country on the basis of Article 172(2) or (4) of the Solvency II Directive[53]. BaFin published an interpretative decision on this subject on 30 August 2016 in response to a large number of inquiries from German and foreign market participants.[54] Among other things, the interpretative decision addresses the effects of the new legal position on new business as well as the exemptions from the authorisation requirement.

1.8 Guidance notices on fitness and propriety

The legislation extended the focus of the supervisory authorities from the management board to the supervisory board some years ago. Since 2009, BaFin's supervisory activities have also covered the members of administrative and supervisory bodies.

Special requirements

For the purpose of defining the activities of the supervisory boards of insurers, the corporate law provisions of the German Stock Corporation Act (*Aktiengesetz*), as added to or modified by regulations under co-determination and supervisory law, must be observed. In accordance with the German Audit Reform Act (*Abschlussprüfungsreformgesetz*), all insurance undertakings within the scope of Solvency II must ensure when appointing members of supervisory boards that at least one member has professional knowledge of accounting or the audit of financial statements.

Collective capabilities

Furthermore, the members of the supervisory board as a whole must be familiar with the industry in which the company operates. In order to be able to discharge their responsibilities in the supervisory board, the members must be able to demonstrate that they have dependable basic knowledge of the insurance sector. In addition, the subject areas of investment, underwriting and accounting must in any event be covered within the supervisory body. BaFin will pay particularly close attention to these points in future in relation to new appointments of supervisory board members.

Supporting guidance notice

BaFin revised its guidance notice on the fitness and propriety of members of administrative or supervisory bodies in November (see info box "New guidance notices on fitness and

New guidance notices on fitness and propriety

BaFin has revised and updated its guidance notices on the fitness and propriety of management board members and members of administrative or supervisory bodies.[55] It has also published for the first time a corresponding guidance notice for persons responsible for key functions or working within those functions. Under Solvency II, most insurers must establish four key functions as an important element of their system of governance: an independent risk management function, a compliance function, an internal audit function and an actuarial function.

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

54 www.bafin.de/dok/8217490.

55 www.bafin.de/dok/8574532 (only available in German).

propriety"). The new version addresses the collective capabilities of the supervisory body in addition to the particular qualifications of the individual members. The guidance notice contains a table template in which the individual members are expected to record their assessment of their abilities once a year. Taking this as a starting point, the administrative or supervisory body is supposed to prepare a development plan on an annual basis, exploring the potential for improvement or further development.

2 Supervision in practice

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 impact and quality. The market impact 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.

Market impact is measured on a four-tier scale of "very high", "high", "medium" and "low". The quality of the insurers is based on an assessment of the following factors: net assets, financial position and results of operations, growth and quality of management.

BaFin assesses the first two factors using insurance-specific (mainly quantitative) 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 2016:

Slight decline in number of good-quality insurers

In the course of the risk classification, BaFin rated 68.1 percent of the insurers as "A" or "B". The proportion of undertakings in the upper quality ratings therefore remained at the same level as in the previous year. The proportion of undertakings rated "A" and "C" declined in comparison with the previous year, while undertakings assessed as "B" and "D"

Table 16 Risk classification results for 2016

Undertakings in %		Quality of the undertaking				Total
		A	B	C	D	
Market impact	very high	0.2	1.3	0.9	0.0	2.3
	high	1.4	5.8	3.2	0.0	10.4
	medium	1.1	14.5	7.0	0.2	22.8
	low	6.5	37.3	18.3	2.3	64.5
	Total	**9.2**	**58.9**	**29.4**	**2.5**	**100.0**

both recorded an increase. As in the previous years, BaFin did not rate any insurers with high or very high market relevance as having a low quality.

Results in the individual insurance classes

There were no significant movements between quality categories for health insurers. As in the previous year, there were no health insurance undertakings assessed with a "D" rating in the year under review. Health insurers rated as "B" once again represented the majority of the segment with a proportion of more than 60 percent.

In the life insurance and funeral expenses funds segment, most undertakings again received ratings in the middle quality categories. The life insurers recorded a deterioration in the quality of their ratings.

The development of the quality of the property/casualty insurance undertakings generated only minor divergences from the previous year, with more than 80 % of the undertakings rated as "A" or "B".

While there were also no noteworthy movements between categories for the *Pensionsfonds*, a deterioration in the assessed quality of the *Pensionskassen* was recorded. The proportion of *Pensionskassen* rated "B" and "D" increased by one to two percentage points in each case, with a corresponding decline in the undertakings classified as "A" and "C".

There was a modest increase in the number of reinsurance undertakings assessed as "B". The proportion in the upper quality range in the year under review was more than 82 %.

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 also classified all insurance groups subject to Solvency II for which it has responsibility for group supervision at group level in 2016. 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 transfer and control agreements. The annual group-level risk classification reflects the growing importance of the supervision of insurance groups, and was updated and expanded with the introduction of Solvency II. The data resulting from BaFin's group-level risk classification thus generate significant added value and provide aggregated information on the overall position of the group.

2.2 On-site inspections

On-site inspections are planned using a risk-based approach. As well as the results of the risk classification, one of the factors that BaFin takes into account is whether an insurer or *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 105 on-site inspections compared with 72 in 2015. The increase in the number of on-site inspections compared with the previous year reflected both the growth in internal model reviews and a higher number of regular inspections.[56]

Table 17 shows the breakdown of the inspections by risk class.

56 Since 2016, on-site inspections are counted pursuant to a new method and in accordance with the reporting requirements set out in Delegated Regulation 2015/2451 ("Level II").

Table 17 Breakdown of on-site inspections by risk class in 2016

On-site inspections		Quality of the undertaking				Total	Undertakings in %
		A	B	C	D		
Market impact	very high	0	8	5	0	13	12.9
	high	1	14	4	0	19	18.8
	medium	2	19	12	1	34	33.7
	low	3	24	7	1	35	34.7
	Total*	6	65	28	2	101	**100.0**
	Undertakings in %	**5.9**	**64.4**	**27.7**	**2.0**	**100.0**	

* Four on-site inspections were also conducted at unclassified undertakings, bringing the total to 105 inspections.

2.3 Investments of primary insurers

2.3.1 Overview[57]

As at 31 December 2016, the carrying amount of the aggregate investment portfolios managed by German primary insurers under BaFin's supervision amounted to €1,467.8 billion (previous year: €1,408.8 billion), as shown in Table 18. Aggregate investments grew by 4.2% (+€59.0 billion) in 2016. Broken down by insurance segments, health insurers (+5.6%) and *Pensionskassen* (+5.0%) recorded the largest percentage increases. Only the funeral expenses funds recorded a slight decline in investments compared with the prior-year figure.

As in previous years, investments continued to focus on fixed-income securities and promissory note loans. There were minor shifts in fixed-rate investments. For example, the share of directly held listed bonds rose by 12.5% to €235.6 billion in the year under review, while the share of investments at credit institutions declined year on year.

Explanatory notes

With the introduction of Solvency II, insurance undertakings are subject to the requirements of a new reporting system which also covers investments. In view of the absence of comparative figures and since the figures for 2016 were only available at a late stage, the insurers' investments are presented in this Annual Report, probably for the last time, on the basis of Statement 671 (report on the carrying amounts and market values of investments and the coverage of technical liabilities).

Since 1 January 2016, reinsurance undertakings have been exempt from the requirement to submit Statement 671 and they are therefore not included in the table below.

In addition, disclosures relating to the composition of the risk asset ratio and the share of total investments attributable to selected asset classes are also not provided, since from 1 January 2016 the relevant statements no longer need to be submitted.

57 For details of the investments of the individual insurance classes and the *Pensionsfonds*, see chapter IV 2.4.

Table 18 Investments of primary insurers

Investments of primary insurers (carrying amounts, HGB)	Portfolio as at 31 December 2016		Portfolio as at 31 December 2015		Change in 2016	
	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	32,929	2.2	32,656	2.3	273	0.8
Fund units, shares in investment stock corporations and investment companies	504,727	34.4	464,871	33.0	39,856	8.6
Loans secured by mortgages and other land charges and shareholder loans to real estate companies	59,338	4.0	56,994	4.0	2,344	4.1
Securities loans and loans secured by debt securities	1,180	0.1	665	0.0	515	77.4
Loans to EEA/OECD states, their regional governments and local authorities and international organisations	127,481	8.7	127,202	9.0	279	0.2
Corporate loans	14,742	1.0	12,641	0.9	2,101	16.6
ABSs/CLNs	6,392	0.4	5,654	0.4	738	13.1
Policy loans	2,927	0.2	3,350	0.2	-423	-12.6
Pfandbriefe, municipal bonds and other bonds issued by credit institutions	205,287	14.0	219,571	15.6	-14,284	-6.5
Listed bonds	235,645	16.1	209,441	14.9	26,204	12.5
Other bonds	22,077	1.5	19,621	1.4	2,456	12.5
Subordinated debt assets/profit participation rights	24,868	1.7	25,381	1.8	-513	-2.0
Book-entry securities and open market instruments	630	0.0	624	0.0	6	1.0
Listed equities	1,662	0.1	1,778	0.1	-116	-6.5
Unlisted equities and interests in companies, excluding private equity holdings	44,520	3.0	30,481	2.2	14,039	46.1
Private equity holdings	14,936	1.0	13,812	1.0	1,124	8.1
Investments at credit institutions	148,591	10.1	161,864	11.5	-13,273	-8.2
Investments covered by the enabling clause	18,758	1.3	21,160	1.5	-2,402	-11.4
Other investments	1,122	0.1	1,034	0.1	88	8.5
Total investments of primary insurers	**1,467,814**	**100.0**	**1,408,803**	**100.0**	**59,011**	**4.2**
Life insurers	885,120	60.3	851,494	60.4	33,626	3.9
Pensionskassen	155,044	10.6	147,694	10.5	7,349	5.0
Funeral expenses funds	2,059	0.1	2,076	0.1	-18	-0.9
Health insurers	260,654	17.8	246,939	17.5	13,715	5.6
Property/casualty insurers	164,939	11.2	160,599	11.4	4,340	2.7

The figures are based on the primary insurers' quarterly reports for the fourth quarter of 2016 and are only preliminary.

Indirect investments held by insurance undertakings via collective investment undertakings again recorded above-average growth in 2016, rising by +8.6%, and – as in the previous year – now account for over one-third of the aggregate investments of all primary insurers at €504.7 billion. As in previous years, the assets acquired via collective investment undertakings consist mostly of listed securities.

Aggregate direct investments in property rose by 0.8% year on year to €32.9 billion.

2.3.2 Government bonds

Treatment of risk under Solvency II

In 2016 Insurance Supervision addressed the treatment of sovereign risk under Solvency II. BaFin worked together with the industry in a symposium and a workshop to develop good practice approaches which individual undertakings can use as guidance for their own treatment of sovereign risk.

Background

In the past, government bonds and loans to member states of the European Economic Area (EEA) or Organisation for Economic Co-operation and Development (OECD) were essentially classified as risk-free. At least since the European sovereign debt crisis, however, this approach has been subject to a fundamental rethink. It has become clear that government bonds are also exposed to credit or even default risk.

Nevertheless, these risks are not currently reflected in the regulations on the capital charge under Europe's Solvency II supervisory system. Insurers that calculate their solvency capital requirement (SCR) using an internal model must take material sovereign risks into consideration. By contrast, when calculating the SCR using the standard formula, government bonds are only included in interest and currency risk and not spread or concentration risk.

Treatment of risk within Pillar II

Insurers must therefore thoroughly address the question of sovereign risk. This is clear from the new Insurance Supervision Act (*Versicherungsaufsichtsgesetz* as amended) and various guidelines issued by the European Insurance and Occupational Pensions Authority (EIOPA).

The undertakings must take account of the relevant risks in particular in the context of Pillar II, i.e. the requirements for the system of governance. The legislature explicitly envisages dealing with risks within the governance system in application of the prudent person principle pursuant to section 124 of the Insurance Supervision Act, within the risk and solvency assessment (ORSA) under section 27 of the Insurance Supervision Act[58] and as part of the own credit risk assessment in accordance with section 28 (2) of the Insurance Supervision Act in conjunction with the Credit Rating Regulation[59]. Undertakings need to address the

Risk types

Interest rate risk: interest rate risk denotes the risk of changes in the term structure of interest rates, or in the volatility of interest rates.

Currency risk: currency risk denotes the risk of changes in the level or in the volatility of currency exchange rates.

Spread risk: spread risk is the risk of changes in the level or in the volatility of credit spreads, i.e. the yield margin above the risk-free interest rate term structure.

Concentration risk: concentration risk stems either from a lack of diversification in the investment portfolio or from a large exposure to the risk of default by a single issuer of securities or a group of related issuers.

58 See chapter IV 1.1.1.3.

59 http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2013:146:0001:0033:EN:PDF.

issue of sovereign risk comprehensively and thoroughly in these three areas in particular.

BaFin symposium and workshop

On 21 June, BaFin held a symposium in Bonn on the topic of government bonds in the guarantee assets (*Sicherungsvermögen*) of insurers. BaFin Chief Executive Director Dr Frank Grund and other BaFin experts held discussions with representatives of the insurance industry and the Deutsche Bundesbank on how to assess sovereign risks for which no capital charge is currently stipulated under the standard formula.

The industry representatives outlined how they invest in government bonds and manage the associated risk. The German Insurance Association (*Gesamtverband der Deutschen Versicherungswirtschaft* – GDV) and the Bundesbank detailed the impact of the low interest rate environment on investment policy, while representatives of BaFin discussed the treatment of government bonds from a supervisory standpoint.

The undertakings and BaFin agreed that insurers holding government bonds in their portfolios must review these exposures and the associated risks.

Against this background, the Insurance Supervision Directorate continued its dialogue with the industry and organised a related workshop in October.

2.4 State of the insurance sector

The following figures for 2016 are only preliminary. They are based on the interim reporting as at 31 December 2016.

It should also be noted that, in accordance with section 45 of the Insurance Supervision Act, BaFin has exempted certain undertakings falling within the scope of the Solvency II Directive from elements of the interim reporting requirements.[60]

60 For the number of undertakings under supervision, see the Appendix, page 223.

2.4.1 Life insurers

Business trends

New direct life insurance business in 2016 remained at the same level as in the previous year with approximately 5.0 million new policies. At the same time, the total value of new policies underwritten rose by 4.7 % to around €264.2 billion compared with €252.2 billion in the previous year.

The share of the total number of new policies accounted for by term insurance policies increased year on year from 33.1 % to 34.1 %. The share accounted for by endowment insurance policies was roughly unchanged in the same period at 10.1 %, while the share attributable to pension and other insurance contracts fell by 0.9 percentage points to 55.8 %.

Early terminations of life insurance policies (surrender, conversion to paid-up policies and other forms of early termination) declined from 2.4 million contracts in 2015 to 2.3 million contracts in the year under review. The total sum insured of policies terminated early fell accordingly to €98.1 billion compared with €99.0 billion in the previous year. The proportion of early terminations of endowment policies declined from 22.3 % in the previous year to 20.2 %, and the proportion of the total sum insured decreased from 12.5 % to 11.1 %.

There were a total of approximately 84.5 million direct life insurance contracts at the close of 2016, representing a 2.0 % decrease compared with the previous year. By contrast, the sum insured increased by 2.1 % to €3,014 billion. Term insurance policies recorded a decrease in the number of contracts from 13.4 million to around 13.0 million, although the sum insured rose from €739.3 billion to €781.4 billion. Pension and other insurance policies continued their positive trend, with the number of contracts growing from 50.9 % to 52.6 % as a proportion of the total. The share of the total sum insured rose from 53.5 % to around 54.5 %.

Gross premiums written in the direct insurance business of the German life insurers amounted to €84.5 billion in the year under review (previous year: €86.6 billion). This represented a 2.4% decline.

Investments

Aggregate investments increased in the year under review by 3.9% from €851.5 billion to €885.1 billion. Since the level of interest rates on the capital market declined once again, net hidden reserves at the year-end rose to €152.5 billion compared with €132.1 billion in the previous year. This corresponds to 17.2% of the aggregate investments, following 15.5% in the prior year.

Preliminary figures put the average net investment return at 4.3% in 2016, and thus down slightly as compared to the prior-year figure of 4.5%. 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 the *Zinszusatzreserve* (additional interest provision introduced in response to the lower interest rate environment).

Projections

BaFin again prepared projections for the life insurers in 2016. BaFin uses the projections primarily to analyse how four different capital market scenarios it has assumed affect the insurers' performance for the current financial year (see info box "Life insurance projections").

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 in a continued low interest rate environment at an early stage and in a forward-looking and critical manner. It is essential that the life insurers introduce appropriate measures in good time and make the relevant preparations.

Life insurance projections

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 following nine financial years.

Solvency II

On 9 August 2016, BaFin published the first figures for the individual insurance classes under the new Solvency II reporting system.[61] In 2016, a total of 77 of the 84 life insurers under BaFin's supervision used the standard formula and seven undertakings used a partial internal model when calculating the solvency capital requirement (SCR). None of the life insurers used undertaking-specific parameters.

Of the total of 84 life insurers, 46 applied the volatility adjustment in accordance with section 82 of the Insurance Supervision Act and the transitional measure for technical provisions under section 352 of the Insurance Supervision Act. 14 life insurers used only the transitional measure for technical provisions, while nine undertakings employed the volatility adjustment as the only measure. One undertaking applied the transitional measure for risk-free interest rates in accordance with section 351 of the Insurance Supervision Act, i.e. the transitional discount curve, in combination with the volatility adjustment. In total, therefore, 56 life insurers applied the volatility adjustment, 60 life insurers the transitional measure for technical provisions and one life insurer the transitional discount curve (see info box "Transitional measures" on page 153).[62]

61 www.bafin.de/dok/8162184; on the reporting system, see also 1.1.1.1.

62 On the approval procedures under Solvency II, see the Appendix, page 224.

Transitional measures

Solvency II allows the undertakings two transitional measures in connection with the valuation of the technical provisions The application of the transitional measure for risk-free interest rates pursuant to section 351 of the Insurance Supervision Act results in a temporary adjustment of the relevant risk-free interest rate curve, while the application of the transitional measure for technical provisions under section 352 of the Insurance Supervision Act results in a temporary deduction from the technical provisions. The application of one of the transitional measures for risk-free interest rates and technical provisions requires approval from BaFin.

SCR coverage

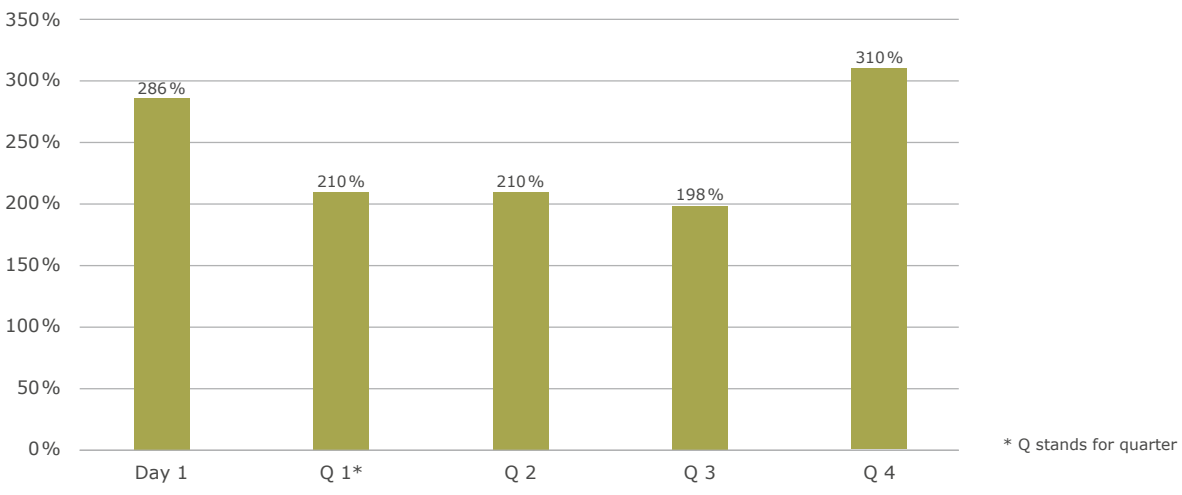
All of the life insurance undertakings were able to demonstrate adequate SCR coverage on the introduction of Solvency II as at 1 January 2016 (Day 1). The industry's SCR ratio (eligible own funds in relation to the SCR) amounted to 283 %. The arithmetic mean of the SCR ratios of all undertakings was 364 %. The coverage ratios deteriorated during the first part of the year as a consequence of changes in the capital market and the interest rate environment. But the ratios recovered with a significant increase at the year-end thanks to a slight improvement in the interest rate environment, the rise in the equity markets and a further decline in spreads in the fourth quarter of 2016.

Figure 6 "Development of SCR coverage ratios" shows the SCR coverage ratios of the sector over time. Only a limited comparison can be made between the data on Day 1 and on the quarterly reporting dates, since BaFin has exempted some undertakings from elements of the interim (quarterly) reporting requirements in accordance with section 45 of the Insurance Supervision Act. This relates to the disclosures for the fourth quarter, since they are still based on the quarterly reports and not the annual reports.

Composition of the SCR

The SCR for life insurance undertakings subject to the interim reporting requirements amounted to € 35.9 billion as at 31 December 2016. The life insurers are primarily exposed to market risk. For those applying the standard formula, this represented on average 78 % of the capital requirements on Day 1 – before taking the effects of diversification into account. Moreover, a significant proportion of the SCR on Day 1 related to underwriting risks for life (29 %) and health (19 %) insurance. In contrast, counterparty credit risks were

Figure 6 Development of SCR coverage ratios



generally less important. Other highly significant factors in the SCR calculation were diversification effects and the loss-absorbing effects of technical provisions and deferred taxes.

Composition of own funds

The own funds eligible for the SCR of the life insurance undertakings subject to the interim reporting requirements amounted to €111.2 billion as at 31 December 2016. On Day 1, 95 % of that amount was attributable to the highest category of own funds (Tier 1). Just under 1 % of the eligible own funds were represented by ancillary own funds. Basic own funds represented the remainder of the own funds. On average, the reconciliation reserve accounted for approximately 61 % of the industry's basic own funds, while surplus funds accounted for around 30 %. Other noteworthy components at the reporting date were share capital including issuing premiums (5 %) and subordinated liabilities (3 %).

Remediation plans

Undertakings that apply a transitional measure and would be reporting inadequate coverage of the SCR without that measure must submit a remediation plan in accordance with section 353 (2) of the Insurance Supervision Act. In the plan, the undertaking must set out the step-by-step introduction of measures planned to generate sufficient own funds or to reduce its risk profile, so that compliance with the solvency capital requirements is ensured without the use of transitional measures at the latest by the end of the transitional period.

During the year under review, 29 life insurance undertakings were required to submit a remediation plan, since they were unable to guarantee adequate SCR coverage without employing transitional measures. BaFin is in close contact with these undertakings in order to ensure that the SCR is complied with on a long-term basis at the latest following the end of the transitional period on 31 December 2031. The undertakings in question are required to comment on the development of the measures in their annual progress reports.

Falling discretionary benefits in the low interest rate environment

Because interest rates for new investments are still very low, many life insurers have further reduced their discretionary benefits for 2017. The current total return, i.e. the sum of the guaranteed technical interest rate and the participation in the interest surplus, for the tariffs available in the market for endowment insurance contracts is an average of 2.5 % for the sector. This figure was 2.8 % in 2016 and 3.1 % in 2015.

Development of the *Zinszusatzreserve* (ZZR)

Since 2011, life insurers have been required to build up an additional interest provision, the *Zinszusatzreserve (*ZZR*)*, to prepare for lower investment income in the future on the one hand and the guarantee obligations on the other, which remain high. The expense for this in 2016 was well over €12.0 billion. The cumulative ZZR at the end of 2016 amounted to €44.1 billion. The reference interest rate used to calculate the ZZR was 2.54 % at the end of 2016.

The expectation is that a substantial expense will also be required in the next few years to build up the ZZR. BaFin will follow future developments at industry and undertaking level very closely, and review whether the ZZR is appropriately calibrated.

New products in life insurance

Long-term contracts with guaranteed interest represent a major area of new business at German life insurers. The most significant product category of this type in recent years was deferred annuity insurance. Typical versions of these products feature interest equal to the applicable maximum technical interest rate (2016: 1.25 %, from 2017: 0.90 %), guaranteed for the life of the policyholder, and annual increases in the guaranteed payments as a result of participation in profits. In the current low interest rate environment, it is becoming

clear that these kinds of guarantees pose a significant risk to life insurers. Accordingly, a growing trend has been observed in recent years towards products with new types of guarantee mechanisms. For example, the guarantees are based to a greater extent on a bullet payment at maturity. Alternatively, guarantees applying at the start of the pension may also be recalculated or, instead of a fixed guarantee of interest equal to the relevant maximum technical interest rate, only the total of the contributions paid in is guaranteed as an endowment benefit. Nevertheless, annuity insurance products with traditional guarantee mechanisms continue to represent a very important part of life insurers' new business.

EIOPA Stress Test 2016 focusing on the low interest rate environment

EIOPA once again carried out a stress test for insurers across the EU in 2016. The stress test was based on the Solvency II valuation rules and was aimed in particular at those insurance undertakings considered to be most vulnerable in a persistent low interest rate environment.

From Germany, 20 large, medium-sized and small life insurance undertakings covering 75 % of the market took part in the stress test. The objective was to identify and assess potential risks for the insurance sector that might arise from unfavourable market developments. The analysis was based in particular on comparisons across the EU and for specific national markets. Individual results were not published as the test was not concerned with the passing or failing of individual undertakings.

For the purposes of the stress test, undertakings had to prepare calculations for a baseline scenario and two stress scenarios as well as provide answers to qualitative questions. The assumptions for the baseline scenario were the same as those for Day 1 reporting (reporting date: 1 January 2016). For the low-for-long stress scenario, EIOPA recalibrated the relevant risk-free yield curve taking into account historical lows and simulated a significant lowering of the yield curve, particularly for longer maturities. In the double-hit stress scenario, a decline in low risk-free interest rates was combined with a fall in the value of almost all asset classes. This scenario can be regarded as a combination of extremely rare and unfavourable circumstances which has never been historically observable.

The results of the stress test confirm BaFin's assessment over recent years that a persistent low interest rate environment continues to represent a challenge for the German life insurance industry. This is because the reaction of the German life insurers included in the test to the low-for-long scenario was particularly sensitive compared with the European average.

2.4.2 Private health insurers

Business trends

The 46 private health insurers supervised by BaFin generated premium income totalling around € 37.1 billion in 2016. This is equivalent to an increase of approximately 1.2 % compared with 2015. The growth in premiums was therefore somewhat higher than in the previous year. One particular reason for the continued low rate of premium growth is that comprehensive health insurance has not experienced any significant increases 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 2016. 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 40.6 million people.

Investments

The health insurers increased their investment portfolio by 5.7 % to approximately € 261 billion in the year under review. Investment remains

focused on fixed-income securities. *Pfandbriefe*, municipal bonds and other bonds accounted for approximately 16 % of all investments. Listed bonds accounted for a further 18 %, while promissory note loans and registered bonds issued by credit institutions accounted for 15 %. The health insurers invested around 28 % of their portfolio in collective investment undertakings. 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, strongly influenced by measures taken by the ECB. During the year under review, interest rates remained at an extremely low level. The health insurers' reserve situation therefore remains comfortable, especially in light of high valuation reserves in fixed-income securities. At 31 December 2016, net hidden reserves in investments amounted to just under €44 billion, or roughly 17 % of investments (previous year: 16 %).

Preliminary figures put the average net investment return at around 3.7 % in the year under review, and therefore at the same level as in the previous year.

Solvency

Since Solvency II came into effect on 1 January 2016, Solvency I now applies only to the few health insurers qualifying as small insurance undertakings within the meaning of section 211 of the Insurance Supervision Act. Preliminary figures indicate that all of these undertakings will comply with the solvency rules as at 31 December 2016.

At the close of 2016, 40 of the total of 46 health insurers were subject to the reporting obligations of Solvency II, while six fell within the scope of Solvency I. The large majority of health insurers apply the standard formula for calculating the SCR. Four undertakings use a partial or full internal model. None of the undertakings used undertaking-specific parameters.

Of the 40 health insurers, three applied the volatility adjustment in accordance with section 82 of the Insurance Supervision Act and the transitional measure for technical provisions pursuant to section 352 of the Insurance Supervision Act. Two health insurers used only the transitional measure for technical provisions, while four undertakings employed the volatility adjustment as the only measure. The health insurers do not apply the transitional measure for risk-free interest rates pursuant to section 351 of the Insurance Supervision Act. Undertakings that apply a transitional measure and would be reporting inadequate coverage of the SCR without the use of that transitional measure must submit a remediation plan in accordance with section 353 (2) of the Insurance Supervision Act. None of the undertakings was required to submit a remediation plan of that type.

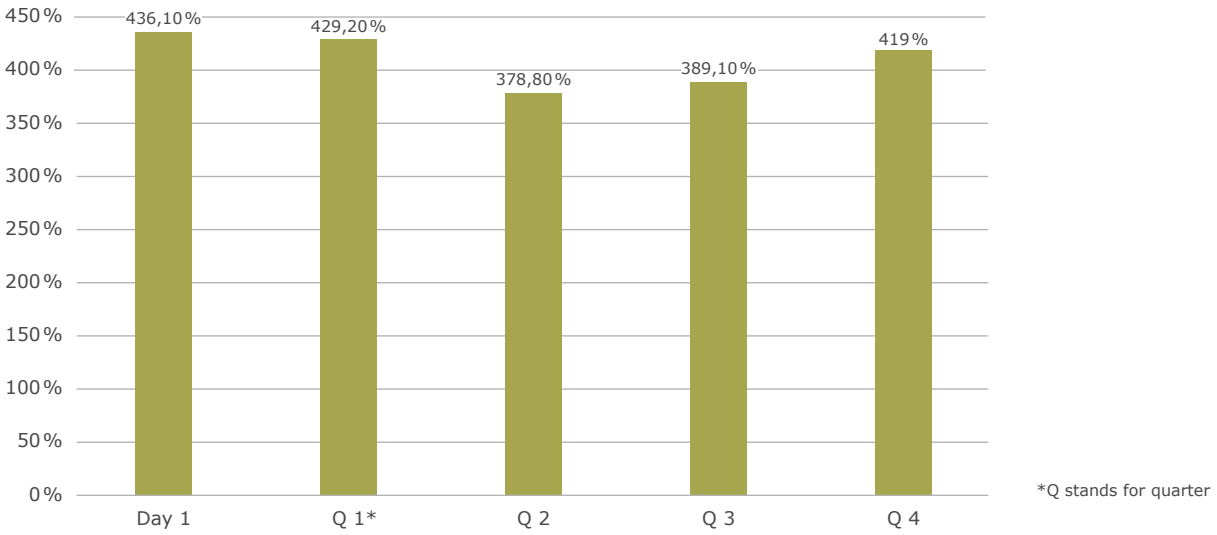
All of the undertakings demonstrated more than adequate coverage of the SCR at 31 December 2016 – as well as on Day 1 and at all the quarterly reporting dates in 2016.

Figure 7 "Development of SCR coverage ratios" on page 157 shows the SCR coverage ratios of the sector.

Only a limited comparison can be made between the data on Day 1 and at the quarterly reporting dates, since some undertakings were exempted from elements of the interim reporting requirements in accordance with section 45 of the Insurance Supervision Act. The variations in the coverage ratios were mainly caused by changes in the interest rate environment and in own funds, in particular the surplus fund.

The sector SCR for all health insurers subject to interim reporting obligations amounted to €5.5 billion as at 31 December 2016. The health insurers are primarily exposed to market risk. This represented approximately 84 % of the capital requirements weighted by gross premiums written for those using the standard formula on Day 1. Around 35 % of the capital

Figure 7 Development of SCR coverage ratios



requirements on Day 1 related to the underwriting risk for health insurance.

The eligible own funds for all health insurers subject to interim reporting obligations amounted to approximately €23.1 billion as at 31 December 2016. The health insurers report the majority of eligible own funds in the reconciliation reserve. On Day 1 the proportion was approximately 60 %. The surplus fund is another major component of own funds, accounting for around one-third. Other own funds components such as share capital including the attributable issuing premium were comparatively unimportant.

Health insurers in the low interest rate environment

The health insurers also prepared projections in 2016 that were submitted to BaFin. The objective of the exercise was to simulate the effects of unfavourable developments in the capital market on their performance and financial stability (see info box "Health insurance projections").

39 insurers took part in the projection exercise. 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 even a persistent low interest rate environment would be tolerable for the health insurers from an economic perspective. As expected, the data generated show that in a low interest rate

Health insurance projections

The projection as at the 30 September 2016 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 financial performance forecast in accordance with HGB for the 2016 financial year and the following four years – in each case in different unfavourable capital market scenarios. In one scenario, BaFin assumed that new investments and reinvestments were made solely in fixed-interest securities with a 10-year maturity and an interest rate of 0.9 %. In a second scenario, the health insurers could simulate new investments and reinvestments according to their individual corporate planning.

Actuarial corporate interest rate

The business model of SLT health insurance (operated using Similar to Life Techniques) is based on premium rates which must be reviewed annually to ascertain whether they are appropriate or whether they may require adjustment. This involves an examination of all the assumptions on which the premium calculation is based – in particular those relating to the development of the net return on investments. Insurers estimate this development and the safety margin which must also 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.

scenario the risk attaching to new investments and reinvestments continues to arise and that investment returns decline. This demonstrates the necessity of lowering the technical interest rate gradually by means of premium adjustments.

The health insurers base the determination of the technical interest rate on the actuarial corporate interest rate (ACIR) (see info box).

For the first time, the current ACIR figures for the 2017 financial year are below the maximum technical interest rate of 3.5 % stipulated in the Health Insurance Supervision Regulation (*Krankenversicherungsaufsichtsverordnung*) throughout the sector. In some cases, they have even fallen significantly faster than in previous years as a result of the ever growing impact of the low interest rate environment. The relevant technical interest rates used for the purposes of premium rates will therefore have to be reduced further in most cases.

Almost 70 % of insureds are affected by the premium adjustments for comprehensive health insurance pending in 2017. The average premium adjustment for the sector amounts to approximately 8 %. Of that figure, the reductions in the technical interest rate are responsible for around three percentage points, while the remaining increases are predominantly due to the development of claims. The health insurers have used a total of approximately € 2.8 billion of the provisions for bonuses to limit the increases in premiums.

2.4.3 Property and casualty insurers

Business trends

Property and casualty insurers recorded a 2.7 % year-on-year increase in gross premiums written in the direct insurance business in 2016 to € 71.0 billion (previous year: € 69.2 billion).

Gross expenditures for claims relating to the year under review declined by 2.0 % to € 23.1 billion (previous year: € 23.6 billion). Gross expenditures for claims relating to prior years rose by 6.5 % to € 17.9 billion. Provisions recognised for individual claims relating to the year under review amounted to € 19.1 billion, compared with € 18.4 billion in the previous year; provisions recognised for individual claims relating to prior years amounted in total to € 58.3 billion, compared with € 56.3 billion in the previous year.

With gross premiums written amounting to € 25.4 billion, motor vehicle insurance was by far the largest insurance class. This represented growth of 3.0 % 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 3.7 % year

on year, while gross expenditures for claims relating to previous years were up 3.1 %. Overall, gross provisions recognised for individual claims relating to the year under review were higher by 3.0 % year on year, while they increased by 3.5 % for outstanding claims relating to 2015.

Property and casualty insurers collected premiums of € 9.4 billion (+1.8 %) for general liability insurance. Claims relating to the year under review declined by 1.7 % in comparison with the previous year to € 960 million. Property and casualty insurers paid out € 3.2 billion for claims relating to earlier years (previous year: € 2.9 billion). Gross provisions for individual claims, which are particularly important in this insurance class, rose by 1.0 % 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 by 3.5 % to € 18.6 billion.

Insurers recorded gross fire insurance premiums written of € 2.2 billion (+2.0 %). Gross expenditures for claims relating to the year under review fell sharply by 16.9 % to € 571.4 million.

Insurers collected premiums for comprehensive residential buildings insurance and comprehensive contents insurance contracts of € 9.5 billion (+5.8 %). Expenditures for claims relating to the year under review declined by 7.7 % year on year. By contrast, provisions for individual claims rose by 8.7 %. Expenditures for claims relating to prior years were almost unchanged compared with the previous year, recording a marginal decline of 0.3 %. Provisions for claims relating to previous years increased slightly by 2.0 %.

Premium income for general accident insurance contracts rose by 2.0 % year on year to € 6.5 billion. Gross expenditures for claims relating to the year under review amounted to € 412.2 million. € 2.3 billion was reserved for outstanding claims relating to the year under review (+0.4 %), almost the same amount as in the prior year.

Solvency I

At 311 %, the solvency margin ratio for property and casualty insurers at the end of 2015[63] was slightly lower than the previous year's figure of 319 %. The decline reflected two mutually offsetting developments: on the one hand, higher solvency margins were required in view of the overall increase in undertakings' business volumes and higher claims expenditures. On the other hand, the insurers recorded growth in their own funds due to capital contributions by shareholders and profits retained. This growth was slightly lower than the increase in solvency margins required, causing the solvency margin ratio to fall slightly overall.

Only one property and casualty insurer did not comply with the Solvency I requirements as at 31 December 2015. 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.

Solvency II

The new Solvency II supervisory regime came into force on 1 January 2016. Solvency I now only applies to around 11 % of property and casualty insurers which constitute small insurance undertakings within the meaning of section 211 of the Insurance Supervision Act.

Those German property and casualty insurers falling within the scope of Solvency II had eligible own funds amounting in total to € 94.9 billion on Day 1. That figure amounted to € 93.7 billion as at 31 December 2016. Of total eligible own funds, 98 % (31 December 2016: 98 %) were attributable to the highest category of own funds (Tier 1). The property and casualty insurers report the majority of eligible own funds in the reconciliation reserve. As at 1 January 2016, this proportion was approximately 83 % of basic own funds.

63 The disclosures relate to the 2015 financial year since projections are not prepared for property and casualty insurers.

The SCR as at 1 January 2016 amounted to around €34.2 billion (31 December 2016: €34.1 billion). This resulted in an average coverage ratio of 277.7% (31 December 2016: 289.0%).

The chart below (Figure 8) shows the SCR coverage ratios of the sector over time. Only a limited comparison can be made between the data on Day 1 and on the quarterly reporting dates, since BaFin has exempted some undertakings from elements of the interim reporting requirements in accordance with section 45 of the Insurance Supervision Act.

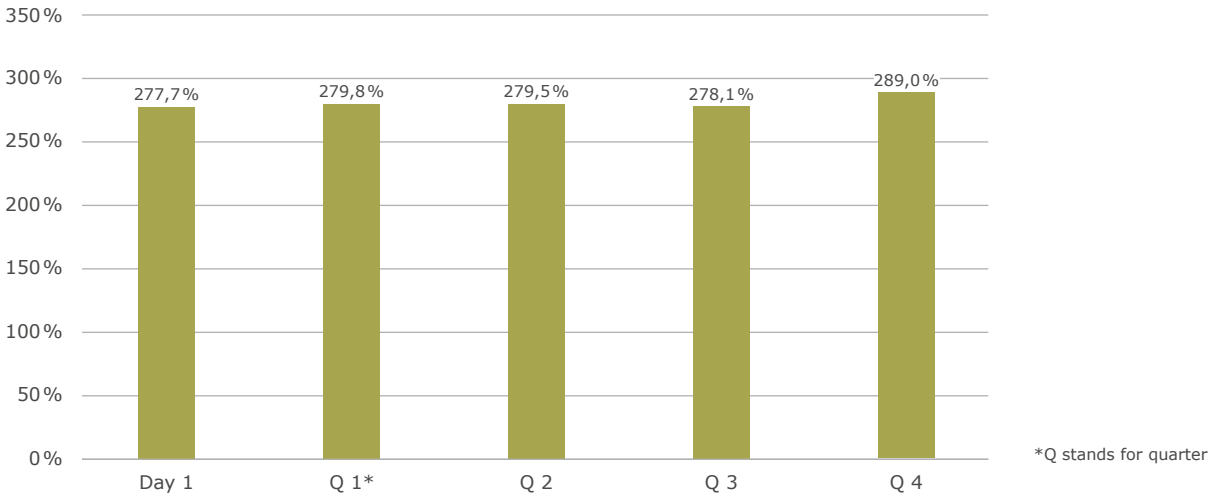
The relatively unchanged coverage ratio – in comparison with the life insurance sector, for example – mainly reflects the fact that property and casualty insurers do not issue long-term guarantees and that the average term of their investments is shorter. They are therefore considerably less sensitive and volatile in response to movements in the capital markets.

As at the 1 January 2016 reporting date, three out of 186 insurance undertakings reported that they did not have adequate coverage of the required SCR under the new Solvency II supervisory regime. At 31 December 2016, all insurance undertakings reporting on a quarterly basis complied with the requirement.

Of the 186 property and casualty insurers within the scope of Solvency II and subject to reporting requirements as at the 1 January 2016 reporting date (Day 1), 173 calculated their SCR using the standard formula. This represents approximately 93% of all property and casualty insurers subject to reporting requirements under Solvency II. Six insurance undertakings calculated the SCR using a partial internal model while seven used a full internal model. Seven insurers took up the statutory option of incorporating undertaking-specific parameters into the calculation of the SCR. Almost all of them were legal expenses insurers.

The most important risk drivers by far were market risk and non-life underwriting risk. These two accounted for 59% and 55%, respectively, of the total capital requirement. Health underwriting risk (7%) and counterparty credit risk (4%) were much less significant. The diversification effect reducing the capital requirements amounted to 26%.

Figure 8 Development of SCR coverage ratios



2.4.4 Reinsurers

Business trends

Claims expenditures for the reinsurers in 2016 were within the expected range, but were nevertheless significantly in excess of the very low figures for the previous year. Natural disasters caused total economic losses amounting to US$175 billion worldwide. While this amount was substantially higher than the prior-year figure of US$103 billion, it was only slightly above the 10-year average of US$154 billion.[64] Losses amounting to US$50 billion were insured. This amount also significantly exceeded the previous year's figure of US$32 billion, but it too was only slightly higher than the 10-year average of US$45 billion. This was due in particular to mild hurricane season. The US American mainland has not been hit by a very strong hurricane for more than ten years now.

The biggest single event for the insurance industry in 2016 was an earthquake in Japan in April. Insured losses amounted to around US$6 billion, but the overall losses to the economy were significantly higher at over US$30 billion. Italy also experienced earthquakes on more than one occasion in 2016. An earthquake in August claimed 299 lives. The rebuilding costs are estimated to be approximately US$5 billion. Storms and flooding at the end of May and the beginning of June 2016 represented the most expensive natural disaster in Germany. Overall losses to the economy across Europe amounted to US$6 billion, of which about half was insured.

The reinsurance market continues to suffer from excess capacity. The more or less average level of claims expenditures worldwide in 2016 intensified the soft market. This applied in particular to the coverage of natural disaster risks, which was reflected in a further fall in prices. The rate of decline in prices was slower, but it appears that the low point has still not been reached. 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 2016 with an issue volume of over US$7 billion. The total amount of catastrophe bonds in circulation even reached a record high of US$26.8 billion.[65] 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 continuing 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.

Solvency I

33 reinsurance undertakings were subject to financial supervision by BaFin in 2016, as before. They had own funds amounting to €74.3 billion as at 31 December 2015 under the old Solvency I supervisory regime (previous year: €72.9 billion). As at the same date, the solvency margin was €8.8 billion (previous year: €8.4 billion). The coverage ratio declined to 846.3 % (previous year: 865.9 %).

Solvency II

30 reinsurance undertakings are subject to the new Solvency II supervisory regime. They

64 Munich Re: Press release 4.1.2017.

65 ARTEMIS: Artemis Website: accessed 1.3.2017.

had own funds amounting to €183.6 billion as at 1 January 2016 under the new supervisory regime. At the same date, the solvency capital requirement amounted to €56.4 billion. This represented an average coverage ratio for the SCR of 325.7%, higher than the insurance industry average of approximately 305%. The SCR coverage ratio rose slightly to 336.0% at the end of the fourth quarter of 2016.

The average coverage of the SCR under Solvency II amounts to around two-fifths of the ratio under the previous Solvency I supervisory regime. The reason for this is that some reinsurers also function as the holding company of an insurance group or financial conglomerate. In such cases, the reinsurance activities are frequently secondary to the holding company function. Since under Solvency I only the reinsurance activities gave rise to a capital requirement, the SCR coverage ratio under Solvency I was correspondingly high. Under Solvency II, however, the holding of investments now also requires capital backing for possible market risks, resulting in significantly lower coverage ratios.

24 of the Solvency II reinsurance undertakings calculated their SCR using the standard formula, one of them applying undertaking-specific parameters. This represents 80% of the Solvency II reinsurance undertakings; the figure for the insurance industry as a whole is 90%.

The most important risk driver for users of the standard formula by far was market risk, accounting for 72% of the basic SCR. This reflects the holding company function of many reinsurers. Other significant risks were non-life underwriting risk representing 33%, and life underwriting risk accounting for 11%. The benefit from the effects of diversification amounted to -26%.

2.4.5 *Pensionskassen*

Business trends

According to the projection as at the 2016 reporting date, the amount of premium income for all *Pensionskassen* in 2016 rose year on year. Premiums earned amounted in total to approximately €6.7 billion in the year under review, a year-on-year increase of around 1.5%. In 2015, they had fallen by 1.6%.

Premium income for the stock corporations newly formed since 2002, which offer their benefits to all employers, declined slightly to approximately €2.6 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* rose year on year. It amounted to around €4.1 billion, as compared with €3.9 billion in the previous year.

Investments

The aggregate investment portfolio of the *Pensionskassen* supervised by BaFin increased by 5.0% in 2016 to €155.1 billion (previous year: €147.7 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 2016, 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 €24.1 billion at the end of the year (previous year: €21.6 billion). This corresponds to roughly 15.5% of the aggregate investments (previous year: 14.6%). The hidden liabilities were negligible at 0.4% overall.

Projections

BaFin prepared a projection for the *Pensionskassen* as at 30 September 2016. 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 SCR coverage ratio was lower than the prior-year level. As a general rule, the undertakings are able to 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 2016, the same as in the previous year. The persistently low interest rates are also posing particular challenges for the *Pensionskassen* (see info box). The projections clearly reveal 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

According to the projection as at the 2016 reporting date, the solvency margin ratio for the *Pensionskassen* was an average of 131 % as at the 2016 balance sheet date, the same level as in the previous year. According to the estimates, two *Pensionskassen* were unable to meet the solvency capital requirement in full as at 31 December 2016. They have already taken steps to improve their risk-bearing capacity and comply with the capital requirements once again in the future.

2.4.6 *Pensionsfonds*

Business trends

Pensionsfonds recorded gross premium income of € 2.7 billion in 2016. The figure for the previous year was € 2.2 billion. 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 rose in the year under review to 917,632 persons compared with 889,247 persons in the prior year. Of those, 579,943 were vested employees who were members of defined contribution pension plans while 42,646 vested employees were

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* closely 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* took action at an early stage to preserve their risk-bearing capacity. This is confirmed by the results of the 2016 projection: almost without exception, the *Pensionskassen* recognised additional provisions. However, it is becoming clear that if the low interest rate environment persists, certain Pensionskassen will require additional funds. For *Pensionskassen* in the form of mutual insurance associations (*Versicherungsvereine*), it would then be appropriate for their owners to make funds available. Stock corporations (*Aktiengesellschaften*) would turn to their shareholders.

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. 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.

members of defined benefit plans. In the case of non-insurance-based benefit commitments under section 236 (2) of the Insurance Supervision Act, the employer is obliged to pay premiums in the payout phase as well. Benefit payouts increased marginally from €1,643 million to €1,691 million in the year under review. The payouts were made to 290,750 persons who drew benefits.

Investments

Investments for the account and at the risk of *Pensionsfonds* grew from €2,190 million to €2,440 million in the year under review. This corresponds to an increase of 11% in investments (previous year: 23%). *Pensionsfonds* portfolios were dominated by contracts with life insurers, bearer bonds, other fixed-income securities and investment units. As at 31 December 2016, net hidden reserves in the investments made by *Pensionsfonds* amounted in total to approximately €168.1 million (previous year: €127.5 million).

Assets administered for the account and at the risk of employees and employers grew only slightly in 2016, from approximately €29.4 billion in the previous year to €31.7 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.

All 29 *Pensionsfonds* supervised by BaFin at the end of the 2016 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

BaFin also prepared projections in 2016 for all 29 *Pensionsfonds* (see info box). The particular focus of the projections was the expected profit for the year, the expected solvency and the expected valuation reserves at the end of the current financial year.

The assessment of the projections indicated that the 29 *Pensionsfonds* included are able to withstand the defined scenarios financially.

The obligations recognised by the *Pensionsfonds* in their financial statements are to a large extent not guaranteed by the *Pensionsfonds*, and the guarantees are covered by congruent reinsurance in some cases. Nevertheless, BaFin considers it necessary for the *Pensionsfonds* also to address the potential medium- and long-term ramifications of a low interest rate phase that persists over the long term. For the purposes of the projections, the *Pensionsfonds* therefore also had to estimate their expense for the *Zinszusatzreserve* (additional interest provision) for the four financial years following the current financial year. They also had to indicate whether they expected to be able to cover the expense with corresponding income, and whether they would be able to comply with the solvency requirements in accordance with the Regulation on the Supervision of *Pensionsfonds* (*Pensionsfonds-Aufsichtsverordnung*) in the future as well. Of 21 *Pensionsfonds* which operate insurance-based business, only 14 were required thus far to establish a *Zinszusatzreserve*. These 14 *Pensionsfonds* are currently financed through congruent reinsurance cover or through current income.

Projections for *Pensionsfonds*

The scenarios defined by BaFin for the projections for the *Pensionskassen* were the capital market situation at the reference date 30 September 2016 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.

Solvency

According to the 2016 projection, all *Pensionsfonds* supervised had sufficient own funds. They therefore complied with BaFin's solvency requirements. At around two-thirds of the *Pensionsfonds*, the level of own funds required by supervisory law was equal to the minimum capital requirement of €3 million for stock corporations and €2.25 million for mutual *Pensionsfonds*. The individual solvency capital requirement for these *Pensionsfonds* is below the minimum capital requirement. This is due either to the relatively low volume of business engaged in or the type of business concerned.

V Supervision of securities trading and the investment business

1 Bases of supervision

1.1 First Financial Markets Amendment Act

The most significant changes in 2016 resulted from the rules on market abuse, with parts of the German First Financial Markets Amendment Act (*Erstes Finanzmarktnovellierungsgesetz*) entering into force on 1 July 2016. This Act transposes the amended Market Abuse Directive (MAD)[1] into German law. The Directive also contains implementing rules for the Market Abuse Regulation (MAR)[2], which is directly applicable. In addition, it refers to the Central Securities Depositories Regulation[3] as well as the Regulation on key information documents for packaged retail and insurance-based investment products (PRIIPs), or PRIIPs Regulation for short.[4]

Under the new market abuse rules applicable since July 2016, the main substantive provisions on market integrity and transparency are no longer contained in the German Securities Trading Act (*Wertpapierhandelsgesetz*). Instead, it is now the MAR which defines which activities fall within the scope of illegal insider trading and market manipulation. By the same token, the MAR contains provisions on accompanying transparency requirements, in particular managers' transactions and ad hoc disclosures.

Substantive changes

In addition to this formal component, the new market abuse regime has also brought about a number of substantive changes. For example, the new requirements now also apply throughout Europe to financial instruments traded only on non-exchange trading platforms, such as multilateral trading facilities (MTFs) and organised trading facilities (OTFs). Under the new legislation, the issuers of these types of financial instruments now also have to publish inside information and prepare the corresponding lists. However, this requirement applies only, if the financial instruments are traded on an MTF or OTF with

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. See chapter II 1.10.

the issuers' permission. What is more, with immediate effect, the prohibition of market manipulation also applies to benchmarks.

The First Financial Markets Amendment Act has also extended the options for imposing sanctions for prohibited market abuse activities. This means that both insider trading by secondary insiders and attempted market manipulation can be prosecuted as criminal offences. In addition, the upper limits of administrative fines for acts of market abuse have been increased. With immediate effect, BaFin can also base the amount of administrative fines imposed on legal persons on their turnover.[5]

The First Financial Markets Amendment Act also includes implementing rules for the PRIIPs Regulation[6] and the Central Securities Depositories Regulation. The rules relate primarily to assigning responsibilities to BaFin and options to impose sanctions. Under the PRIIPs Regulation, manufacturers of packaged retail investment products have to publish key information documents. The Regulation sets out in detail how the requirements for these sources of information have to be implemented in terms of form and content. By contrast, the Central Securities Depositories Regulation contains Europe-wide harmonised provisions for the authorisation and ongoing supervision of central securities depositories.

1.2 BaFin's new administrative fine guidelines under the Securities Trading Act

Since November 2015 and July 2016, BaFin has been able to impose significantly higher sanctions for violations of the Securities Trading Act. The extended options for imposing sanctions are based on the Transparency Directive Amending Directive and the Market Abuse Directive. BaFin provides details of how it makes use of the sanctions available and how it calculates administrative fines in its WpHG Administrative Fine Guidelines II dated 23 February 2017.[7] The revised guidelines apply to violations of the requirements on ad hoc disclosures, voting rights notifications and financial reporting.

In cases of serious offences, especially by consolidated groups with high revenue and a strong market capitalisation, BaFin will impose significantly higher fines in future. The reason for introducing turnover-based administrative fines was that European legislators wanted to allow a more severe level of punishment for larger companies in particularly serious cases. For example, for infringements of financial reporting requirements, BaFin can now impose administrative fines of up to €10 million, 5% of annual consolidated turnover or twice the economic benefit gained from committing the offence. Previously, BaFin was only able to impose fines up to a maximum of €200,000.

The WpHG Administrative Fine Guidelines II specify nominal base amounts, depending on the severity and the issuer's market capitalisation. BaFin calculates the individual fine on this basis, taking any mitigating or aggravating circumstances into account. Given the wide scope of the turnover-based upper limits of administrative fines, BaFin has a responsibility to proceed with a sense of proportion, in particular in the case of less serious offences. In individual cases, BaFin will determine fines that are far below the maximum levels specified by law.

1.3 No criminal liability loophole for market abuse

In the context of implementing the Market Abuse Regulation, it was at times argued in the specialist literature that on 2 July 2016 no effective criminal and administrative fine provisions were in place for infringements relating to insider trading and market manipulation. This lack of criminal liability was based on the most lenient law and would therefore also apply to all acts committed

5 See 1.2 and chapter II 3.1.

6 See chapter II 1.10.

7 www.bafin.de/dok/9221006.

before 2 July 2016 for which no final ruling had been made; this was tantamount to a general amnesty. BaFin did not share this opinion. On the contrary, the Securities Trading Act contained adequately specified criminal and administrative fine provisions even on 2 July 2016.

The German Federal Court of Justice (*Bundesgerichtshof* – BGH) concurred with this view and declared in a court order dated 10 January 2017[8] that, as a result of the amendments to section 38 (3) no. 1 and section 39 (3d) no. 2 of the Securities Trading Act, no loophole had been created in the ability to prosecute market abuse as at 2 July 2016. The newly worded criminal and administrative fine provisions involve blanket penal provisions which make a static reference to the applicable provisions of the MAR as amended on 16 April 2014. According to the German Federal Constitutional Court (*Bundesverfassungsgericht*), these kinds of static references are not problematic.

Nor did the references lead into the void, because the MAR had already been in force since the middle of 2014 and had merely not (yet) become applicable at the Community level as at 2 July 2016. According to the Federal Court of Justice, references in the German criminal and administrative fine provisions to the provisions of the MAR led to a situation where these provisions were declared (jointly) applicable in Germany by the German legislators, even before they became directly applicable from 2 July 2016 onwards.

The principle of legal clarity under constitutional law was likewise not in conflict with punishability, as both the reference and the source standards had been properly promulgated so that anyone could have foreseen which behaviour was prohibited and liable to punishment or an administrative fine. This was because in substance the principle of legal clarity entailed the obligation to describe the conditions of punishability to such a level of detail that the significance and scope could be recognised or determined through interpretation. In the opinion of the Federal Court of Justice, the prohibition provisions of Articles 14 and 15 of the MAR in conjunction with Articles 7, 8 and 12 of the MAR were sufficiently transparent.

The assessment should in particular take into account the fact that the normal addressees were usually natural persons with a specialised education. Where that was not the case, the Federal Court of Justice believed that the players involved had a duty to seek training and advice.

In a case of insider trading in October 2016, the Regional Court (*Landgericht*) in Mannheim had not identified any legal loophole with regard to punishing criminal insider trading either.

1.4 MiFID II and the Second Financial Markets Amendment Act

On 21 December 2016, the Federal Cabinet (*Bundeskabinett*) adopted the government draft of the German Second Financial Markets Amendment Act (*Zweites Finanzmarktnovellierungsgesetz*). This law transposes in particular the Markets in Financial Instruments Directive II (MiFID II)[9] into national law.

Legislators had transposed its predecessor, MiFID I[10], into national law almost ten years ago. As the basic legal framework for trading in financial instruments, MiFID II provides for significantly tighter regulation than MiFID I, particularly in view of the large number of clarifying implementing acts. MiFID II was the European legislators' response to the financial crisis, as well as to technology-driven changes in the market infrastructure and an increased need for comprehensive investor protection.

The Second Financial Markets Amendment Act contains extensive amendments in particular to the Securities Trading Act, as well as to other regulatory frameworks, such as the German Stock Exchange Act (*Börsengesetz*) and the German Banking Act (*Kreditwesengesetz*).

8 Case ref. 5 StR 532/16.

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

10 Directive 2004/39/EC.

The trading venues under supervision now also include organised trading facilities (OTFs) in order to close gaps in the supervision of trading platforms. Another new requirement is that data reporting services providers will have to be authorised and supervised on an ongoing basis in order to guarantee reliable, transparent and cost-effective access to important market data for financial market participants.

Securities trading regulation

The Second Financial Markets Amendment Act also includes rules on monitoring trading in commodity derivatives. To this end, the Securities Trading Act will include a dedicated section on position reporting and the control of the corresponding positions of the trading participants. In addition to transparency requirements, it will also have rules on position limits for commodity derivatives.

The obligation to provide pre- and post-trade transparency will in future cover a large number of additional financial instruments. In the past, this had only related to shares and certificates representing shares. Exemptions from the pre-trade transparency requirements have been defined more narrowly and will be handled more consistently. In addition, with the introduction of MiFID II, the form and contents of reports provided by investment firms to the supervisory authorities on transactions entered into will be adjusted and harmonised further throughout Europe.

Share and derivatives trading is subject to the additional fundamental obligation to trade on organised trading venues (with defined exceptions) in order to increase transparency. Moreover, new legal requirements are intended to help improve competition among trading venues and central counterparties. In regulating high-frequency trading, German legislators have proactively already laid down some requirements of MiFID II in national law. Further technical details are contained in the defining rules issued by the European Commission.

Conduct of business rules

There will also be changes to the conduct of business rules and organisational requirements of the Securities Trading Act, which are intended to enhance investor protection: for the first time, MiFID II sets out EU-wide harmonised rules for independent investment advice. In the past, legislators had regulated this as fee-based investment advice at the national level. Institutions providing this service may generally not accept any commissions. In exceptional cases, commissions may be accepted if they are passed on to customers. What is more, the advice in this context must be based on a sufficiently broad range of products that is not limited to just a few financial instruments. At the same time, the Second Financial Markets Amendment Act will further differentiate the requirements for commission-based advice and the obligations of investment services enterprises to provide information.

Product governance

The second far-reaching amendment is the introduction of product governance requirements[11]. The processes to be set up to this end will apply even before the issuers provide any investment services, i.e. at the time the financial instrument is produced. The intention is to give BaFin the ability to consistently monitor the entire product lifecycle of a financial instrument. The future requirement to determine the target market for a financial instrument is intended to ensure that investors are offered financial products that match their needs. The rules on product intervention contained in MiFID II were implemented in Germany when the Retail Investor Protection Act (*Kleinanlegerschutzgesetz*) came into effect in 2015.

Moreover, legislators have significantly increased the range of sanctions available for infringements of supervisory law.[12]

1.5 Amendments to the Prospectus Regulation

The European Parliament, the European Council and the European Commission have reached agreement on a new regime for

11 See chapter II 1.1.

12 See chapter II 3.1.

securities prospectuses. Based on the European Commission's proposal of 30 November 2015, a Prospectus Regulation[13] will replace the Prospectus Directive within the framework of the planned capital markets union.

Legislators have put together a new regulatory framework to reduce the effort and cost of preparing a prospectus, but also to facilitate access to the capital market, especially for small and medium-sized enterprises (SMEs). To this end, the threshold for public offers will be raised to €1 million over a 12-month period. No prospectus will be required below this total. In addition, the member states will in future be able to exempt offers totalling up to €8 million over the same period from the prospectus requirement at the national level. At the same time, however, investor protection is to be improved by requiring information such as the risk factors to be presented better.

Outside of the organised market, SMEs and unlisted companies with fewer than 500 employees will be given the possibility to prepare an EU growth prospectus. This will also apply to companies with a market capitalisation of less than €500 million seeking access to an SME growth market. In terms of contents, the requirements for the EU growth prospectus will be significantly less complex in future, and its format will be standardised in order to facilitate its preparation. Secondary issuances by issuers that are already subject to subsequent transparency requirements because of their participation in the organised market or SME growth market will also benefit from simplified prospectus requirements.

As a departure from the Commission's original proposal, the existing simplifications for securities with a minimum denomination of €100,000 will be retained. Legislators have, however, added bonds to this regime, if irrespective of their minimum denomination they are to be admitted to an organised market or a segment of the organised market to which only qualified investors will have access.

To present the information in a way that is easier for investors to understand, the Regulation will limit the size of the prospectus summary to a maximum of seven sides of A4-sized pages in future. The securities-related information in the summary can also be replaced with the corresponding elements from a key information document prepared in accordance with the PRIIPs Regulation.[14]

Securities prospectuses are also to become more easily accessible for investors by implementing a new Europe-wide online database operated by the European Securities and Markets Authority (ESMA). ESMA will grant free-of-charge access to all prospectuses approved by the national competent authorities.

Finally, under the amended regulation, shorter review periods will apply to frequent issuers that prepare the prospectus as a multi-part document using a universal registration document. This new document contains both the information on the issuer required under the Prospectus Regulation and the annual reports required under the Transparency Directive. It is filed in advance with the competent supervisory authority.

1.6 Act Implementing the UCITS V Directive

The German Act Implementing the UCITS V Directive (*OGAW-V-Umsetzungsgesetz*) entered into force on 18 March 2016. It firstly transposes the provisions of the fifth Directive on undertakings for collective investment in transferable securities (UCITS Directive)[15], into German law. Secondly, the Act Implementing the UCITS V Directive introduces some changes that are not conditional on the Directive, for example rules regarding the granting of loans by alternative investment funds (AIFs).[16]

13 At the time of going to press, the ordinary legislative procedure had not yet been completed. For details on the capital markets union, see chapters I 2.1. and II 6.1.

14 See chapter II 1.10.

15 Directive 2014/91/EU, OJ EU L 257/186.

16 www.bafin.de/dok/7860058.

Remuneration schemes

Until now, only German AIF management companies (*AIF-Kapitalverwaltungsgesellschaften*) have had to determine remuneration policies for senior management and certain employees. In accordance with the UCITS V Directive, this now also applies to German UCITS management companies, which are required to establish and maintain remuneration policies and practices for senior managers and those categories of staff whose professional activities have a material impact on the risk profiles of the management company or the collective investment undertaking. The aim is to establish a sound and effective risk management system.

UCITS depositary

The UCITS V Directive has also expanded the range of tasks and duties of the UCITS depositary. In particular, more details were provided on the depositary's duties regarding assets that are capable of being held in custody and those that are not. The Act Implementing the UCITS V Directive also sets out stricter rules for the liability of depositaries. Until now, they were, under certain conditions, able to contractually exempt themselves from liability for the loss of financial instruments entrusted for safe keeping to a sub-delegate. This option will no longer be available.

Provisions on administrative fines

In addition, the UCITS V Directive strengthens the competent authorities' sanctioning powers. The ability to impose significantly higher fines and to publish the details is to act as a deterrent. This is why the German legislators restructured and increased the scale of administrative fines in the Act Implementing the UCITS V Directive. The old two-tier system with maximum administrative fines of €100,000 and €50,000 has been replaced with a three-tier system with fines of up to €5 million, €1 million or €200,000.[17]

Granting loans for the account of AIFs

In addition, the Act Implementing the UCITS V Directive will modify the German Investment Code (*Kapitalanlagegesetzbuch*) to the extent that German AIF management companies may now, under specific conditions, grant loans for the account of closed-ended special AIFs. The conditions include, for example, that the company may borrow no more than 30% of the AIF capital for the account of that closed-ended special AIF and that the loan will not be granted to consumers. Specific risk diversification guidance must also be observed when granting the loan.

1.7 UCITS: independence of depositary included in the same group

In Commission Delegated Regulation (EU) 2016/438, which entered into force on 13 October 2016, the European Commission sets out in detail the conditions linked to the independence requirement for UCITS management companies and depositaries. The regulation specifies details of the independence requirement in particular for the case that there is a group link between the depositary and the management company. This applies if both belong to the same group. If such a group link exists, at least one third of the members or two persons, whichever is lower, on the supervisory board concerned must be independent.
The regulation also defines the term of independence. One of the requirements for the independence of supervisory board members is that they are free of any business, family or other relationship with the management company, the depositary or any other undertaking within the group. Otherwise this could give rise to a conflict of interest or impair the judgement of the supervisory board member.

Where the management company appoints a depositary to which it has a link or a group link, the regulation specifies that certain documentary evidence has to be provided: the management company has to make an assessment comparing the merits of appointing a depositary with a link or a group link with the merits of appointing a depositary that has no such link. The comparison has to take into account at least the costs, the expertise,

17 See chapter II 3.

financial standing and the quality of services provided by all depositaries assessed. In addition, the management company has to prepare a report based on this assessment, justifying the appointment of the depositary with a link or group link.

1.8 OTC derivatives

1.8.1 Recovery and resolution of central counterparties

The European Market Infrastructure Regulation (EMIR)[18], which requires standardised over-the-counter (OTC) derivatives to be cleared through a central counterparty (CCP), was intended by European legislators as, among other things, a response to the financial crisis. These CCPs need authorisation and are subject to regulatory requirements. Trading in standardised OTC derivatives has become safer, because the risk of contagion is reduced. Yet the central counterparties may themselves expand to such an extent that this could give rise to systemic risks. If such a central counterparty were to default, financial stability could be adversely affected.

In order to counter these risks adequately, the European Commission published a proposal for a regulation for the recovery and resolution of central counterparties in November 2016. The new regulatory framework will primarily implement the international recommendations on the recovery of central counterparties made by the Committee on Payments and Market Infrastructures of the International Organization of Securities Commissions (CPMI-IOSCO) and those on their resolution made by the Financial Stability Board (FSB). The European Commission's proposed regulation is to ensure that the central counterparty's functions that are critical for the financial market are maintained even in the event of recovery or resolution. The negotiations at the European level to finalise the regulation began in February 2017.

The proposed regulation firstly contains rules on recovery and resolution actions that allow open positions to be closed and uncovered losses to be settled, which could otherwise occur if clearing members default (default losses). Secondly, rules are being proposed under which recovery and resolution actions can also be used to settle losses that arise from the central counterparty's operations (non-default losses).

Review of EMIR

In addition, the European Commission published a report on EMIR which assesses comments made by market participants on the implementation of the regulation. At the same time, the Commission held out the prospect of measures intended to simplify the existing requirements, especially for so-called non-financial counterparties (i.e. undertakings other than banks, insurance undertakings or fund companies), making the process more efficient and reducing disproportionately high costs and negative factors.

The report deals with different aspects of EMIR. For example, it raises the question of whether thresholds above which more stringent legal requirements apply to non-financial counterparties are appropriate. Another issue is whether it will be necessary every time for the two parties involved to submit one data record each when reporting such derivative transactions to the trade repository. A number of factors make it difficult, especially for smaller undertakings subject to the clearing obligation, to gain access to a central counterparty in order to meet this obligation. One reason may be, for example, that, due to their small size, these undertakings are forced to involve a clearing member. These clearing members are banks which are subject to the Capital Requirements Regulation (CRR).[19] The CRR specifies relatively high capital requirements for these types of services, with the result that the provision of these services is not profitable, especially if the customer base includes small customers only. With regard to the supervision of central counterparties, the Commission is considering additional transparency requirements

18 Regulation (EU) No 648/2012, OJ L 201/1.

19 Regulation (EU) 575/2013, OJ EU L 176/1.

in order to avoid procyclical effects in the provision of collateral to a central counterparty and thus to prevent clearing via central counterparties from adding to the pressure on banks in crisis situations.

The EMIR review had begun in 2015 with a consultation process initiated by the Commission. Once the initial discussions with the member states have been conducted, the first legislative proposals are expected in the first half of 2017.

1.8.2 Collateralisation requirement for contracts not cleared by a central counterparty

The delegated regulation on risk-mitigation techniques for non-standardised OTC derivatives[20] entered into force on 4 January 2017.[21] The underlying regulatory technical standard had been developed jointly by the three European Supervisory Authorities (ESAs).

European regulations

As early as 2012, the EU had specified in EMIR minimum requirements for risk management and transparency in OTC derivatives transactions. For example, Article 11(3) of EMIR requires risk management procedures that prescribe the timely, accurate and appropriate exchange of collateral for OTC derivative contracts not cleared through a central counterparty (CCP).

The delegated regulation provides more details on this requirement and in this process also takes guidance from the principles of the Basel Committee on Banking Supervision (BCBS) and the International Organization of Securities Commissions (IOSCO) in order to ensure a maximum of international harmonisation and consistency. Firstly, it contains requirements for a risk management process that allows the timely, accurate and appropriate exchange of collateral. Secondly, it governs the processes that the counterparties and competent authorities have to take into account when exempting intragroup transactions from the collateralisation requirement and lays down the criteria to be met in this regard.

Types of collateral

The EU has opted for variation margins and initial margins as collateralisation instruments. The variation margin is used to balance continual fluctuations in value of the derivatives contracts on a regular basis. The initial margin, by contrast, is used to cover current and future fluctuations in value expected between the last time margin was collected and the sale of the position. Counterparties can use a standardised approach or an internal model to calculate the initial margin. The delegated regulation contains requirements for these models as well as for the timing of when the collateral has to be provided.

The regulation also defines the assets eligible as collateral and contains rules on how to measure these assets and on the associated haircuts. Moreover, it describes the requirements for segregating initial margins. Another requirement is that the counterparty accepting collateral must not re-pledge or otherwise reuse initial margins it has collected as collateral. Additionally, concentration limits on initial margins collected are to ensure that there is an adequate selection of individual issuers, types of issuers and asset classes.

Scope of application

The requirements apply to financial counterparties, including, among others, banks and insurance undertakings, and non-financial counterparties exceeding the clearing threshold referred to in Article 10 of EMIR. In order to maintain proportionality, the delegated regulation defines certain thresholds at the group level below which certain requirements do not apply. It also includes product exemptions.

What is more, the competent supervisory authority can, under certain circumstances, exempt OTC derivatives from the

20 Delegated Regulation (EU) 2016/2251, OJ EU L 340/9.

21 www.bafin.de/dok/8728786.

collateralisation requirement, if both counterparties belong to the same group.[22]

Start of the collateralisation requirement

Market participants with a nominal volume of non-centrally cleared OTC derivatives in excess of €3 billion have been obliged to exchange the initial and variation margin since 4 February 2017. Thanks to the gradual phase-in of the regulations, counterparties with lower volumes had more time to prepare for their application. They have been subject to the variation margin requirement since 1 March 2017. There will be another four steps, starting on 1 September 2017, to phase in the requirement to exchange initial margins.

Outlook

In 2016, a joint BCBS and IOSCO working group (monitoring group) dealt with the issue of what problems could arise during national implementation of the global collateralisation standards. If the group identifies serious inconsistencies in the implementation, it can propose amendments to the global standards in the medium term.

Consistent application must also be ensured at the European level. To this end, the three European Supervisory Authorities are planning to draw up and publish questions and answers relating to the delegated regulation.

22 Information on exemptions from the collateralisation requirement and on the application process for intragroup exemptions can be found at www.bafin.de/dok/8715560 (only available in German).

2 Monitoring of market transparency and integrity

2.1 Market analyses

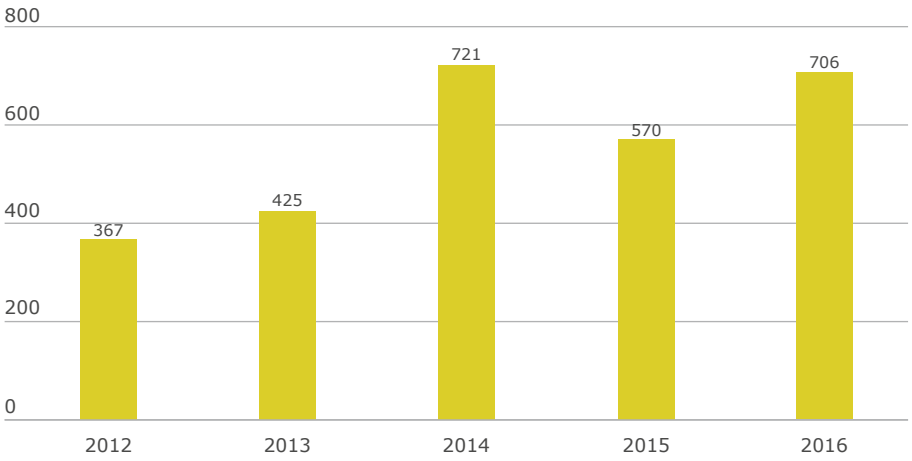
In the year under review, BaFin analysed 706 cases (previous year: 570) for indications of market manipulation and insider trading. This brought the number of analyses back to the 2014 level (721; see Figure 9 "Market analyses" on page 175).

In 149 cases (previous year: 125), BaFin found initial indications of market abuse. 103 of these cases (previous year: 79) related to market manipulation and 46 (previous year: 46) to insider trading.

Most of the analyses were conducted in response to suspicious transaction reports. Since July 2016, these cases have been governed by the new provisions of the MAR. Market participants brokering or executing transactions on a commercial basis have since then been required to investigate trading activities with the aid of effective systems. They are required to scrutinise transactions for irregularities and to report any orders or transactions they have identified as suspicious. The same rules apply also to market operators as well as investment firms operating a trading venue. In addition, the legal definition of market abuse has been expanded. They include, for example, attempted market manipulation or insider trading performed by cancelling exchange orders. These amendments were the reason for a sharp increase in suspicious transaction reports to a total of 1,274 in the year under review (previous year: 547). They related to 765 different financial instruments (previous year: 331).

In the year under review, BaFin compiled 16 experts' reports on market abuse behaviour for public prosecutors' offices and courts. Where these proceedings related to cases of market manipulation, the reports were in most cases requested to establish whether manipulative acts had an effect on the market price of a financial instrument. One case related to insider trading, where the BaFin expert calculated the special advantage the insider had attained through their action.

Figure 9 Market analyses



In addition, BaFin published 7 consumer warnings on its website in order to alert private market participants of concerted manipulation attempts, such as phone calls or spam e-mails.

Market manipulation analyses

81 of the total of 103 positive market manipulation analyses dealt with sham activities such as wash sales and pre-arranged trades (previous year: 42; see Figure 10 "Subject matter of positive market manipulation analyses"). In 15 cases, there were indications of information-based manipulation, such as incorrect, misleading or withheld information as well as manipulation in the form of scalping (previous year: 32). Almost all other cases were based on manipulation of order situations or reference prices.

Broken down by stock exchange segment, 68 % of the alleged cases of market manipulation were identified on the regulated unofficial market (*Freiverkehr*). The share attributable to this segment was thus up slightly on the previous year (59 %). By contrast, the share of analyses relating to the regulated market declined to 32 % (previous year: 41 %).

Figure 10 Subject matter of positive market manipulation analyses

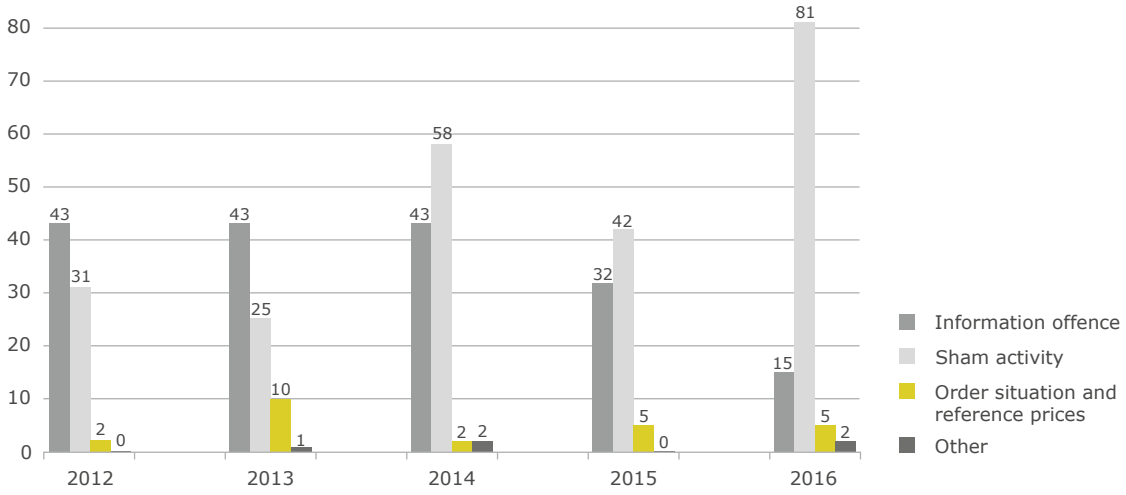
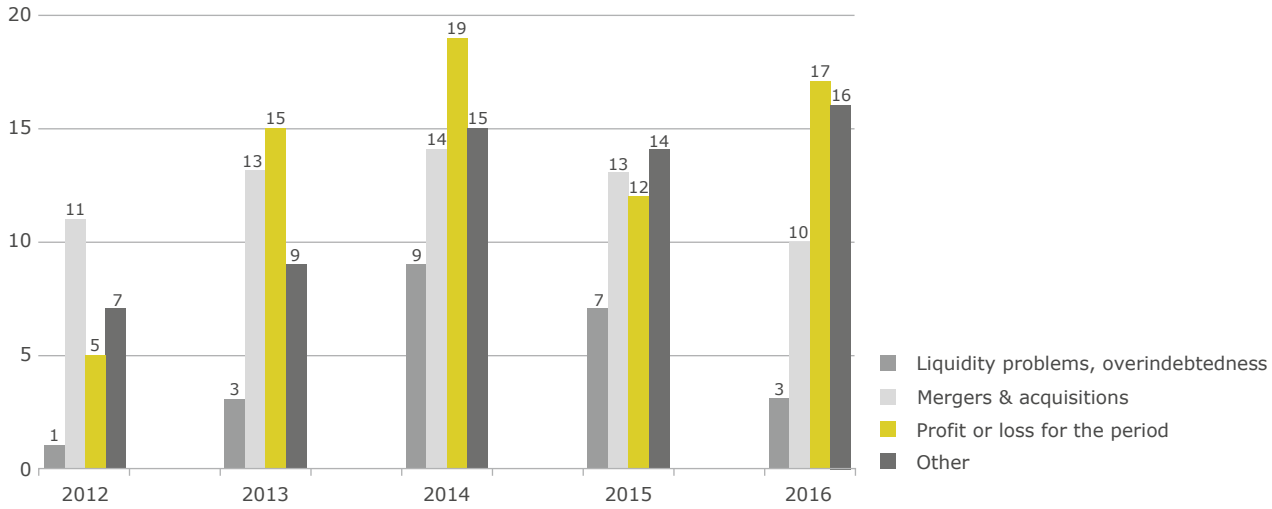


Figure 11 Subject matter of positive insider trading analyses



Insider trading analyses

As for alleged insider trading, the number of positive analyses conducted in 2016 was the same as in the previous year, at 46 cases. The main focus – 17 cases – was on issues relating to companies' earnings figures (previous year: 12; see Figure 11 "Subject matter of positive insider trading analyses"). 10 cases were recorded in connection with mergers and acquisitions (previous year: 13). The remaining cases are evenly divided among different categories of inside information. As in 2015, most alleged insider trading took place on the regulated market (80 %; previous year: 78 %). The remaining cases (20 %; previous year: 22 %) related to the regulated unofficial market.

Recommendations by financial analysts

BaFin's market analyses also cover recommendations issued by financial analysts, which have been subject to a new basis in law since the middle of 2016. Articles 20 and 21 of the MAR and the accompanying Delegated Regulation of 9 March 2016 have since then replaced section 34b of the German Securities Trading Act (*Wertpapierhandelsgesetz*), old version, and the German Financial Analysis Regulation (*Finanzanalyseverordnung*). In substance, they largely correspond to the previous legal situation. This means that information has to be presented objectively and parties producing or disseminating it must disclose any conflicts of interest. However, the MAR does not use the term "financial analysis" and instead refers to "investment recommendations or other information recommending or suggesting an investment strategy". These recommendations do not take the individual investor's investment objectives into account and must therefore not be confused with the individual recommendations that investment advisers issue during individual investment advice.

At the end of 2016, 431 credit and financial institutions that provide their customers with in-house recommendations or recommendations developed by third parties in accordance with the MAR were supervised by BaFin (previous year: 383). The increase is mainly attributable to a larger number of savings banks and cooperative banks passing on recommendations within the meaning of the MAR, which they obtained from their respective top institutions. In addition, BaFin was notified of 213 independent natural or legal persons or associations of individuals that produced or disseminated recommendations within the meaning of the MAR (previous year: 198).

2.2 Market manipulation

Investigations

In 2016, BaFin investigated a total of 272 (previous year: 256) new cases of suspected market manipulation (see Table 19 "Market manipulation investigations"). Again, more than half of the formal investigations launched – 178 (previous year: 135) analyses in total – were based on referrals by the trading surveillance units at the German stock exchanges. Public prosecutors' offices and police authorities initiated a total of 11 (previous year: 17) investigations by BaFin.

Cooperation with foreign supervisory authorities again played an important role in 2016. BaFin cooperated with the supervisory authorities of a total of 23 different countries (previous year: 24) in 113 cases (previous year: 107). Foreign authorities from 14 countries (previous year: 17) requested assistance from BaFin in 42 cases (previous year: 55).

BaFin found evidence of market manipulation in 106 cases completed in 2016 (previous year: 160). It filed complaints against 275 suspects with the relevant public prosecutor's office (previous year: 290).

In 7 other cases (previous year: 10) involving a total of 9 persons (previous year: 14), there was evidence that an administrative offence had been committed. In 40 cases, the investigation did not find any evidence of violations (previous year: 44). The number of investigations still pending at the end of 2016 was 398 (previous year: 279).

Sanctions

In 2016, 10 individuals were sentenced for market manipulation following a full public trial (previous year: 6), 3 individuals were acquitted (previous year: 1; see Table 20 "Completed market manipulation proceedings" on page 178). The judges passed sentences against 13 other persons (previous year: 10).

The public prosecutors' offices discontinued a total of 310 investigations (previous year: 228). In 166 of these cases (previous year: 97), a conviction was not sufficiently probable to bring a charge in accordance with section 170 (2) of the German Code of Criminal Procedure (*Strafprozessordnung*). Another 17 investigations (previous year: 37) were provisionally discontinued in accordance with section 154 (f) of the Code of Criminal Procedure because the defendant's place of abode was unknown. In addition, the public prosecutors' offices discontinued 49 cases (previous year: 29) in accordance with section 153 of the Code of Criminal Procedure, because they considered the

Table 19 Market manipulation investigations

Period	New investigations	Investigation results						Ongoing investigations
		Investigations discontinued	Investigations referred to public prosecutors' offices or BaFin Administrative Fines Division					
			Public prosecutors' offices		Administrative Fines Division*		Total (cases)	Total
			Cases	Individuals	Cases	Individuals		
2014	224	33	156	311	6	9	162	237
2015	256	44	160	290	10	14	170	279
2016	**272**	**40**	**106**	**275**	**7**	**9**	**113**	**398**

* The difference between the number of referrals to the BaFin Administrative Fines Division and the number of administrative fine proceedings initiated by BaFin (see 7.1) is attributable to the use of different processes.

Table 20 Completed market manipulation proceedings

Period	Total	Decisions by the public prosecutors' offices*				
		Proceedings discontinued				
		Proceedings discontinued in accordance with sections 152 (2) and 170 (2) of the Code of Criminal Procedure	Proceedings discontinued in accordance with section 153 of the Code of Criminal Procedure	Proceedings discontinued in accordance with sections 154, 154a of the Code of Criminal Procedure	Proceedings discontinued in accordance with section 154f of the Code of Criminal Procedure	Proceedings discontinued in accordance with section 153a of the Code of Criminal Procedure
2014	211	77	29	14	22	52
2015	256	97	29	16	37	49
2016	**345**	**166**	**49**	**28**	**17**	**50**

Period	Final court judgements following criminal proceedings*				Rulings following administrative fine proceedings	
	Proceedings discontinued by the court in accordance with section 153a of the Code of Criminal Procedure	Convictions following summary proceedings without trial	Convictions following full trial	Acquittals	Proceedings discontinued	Final administrative fines
2014	2	3	3	1	0	7
2015	1	10	6	1	4	6
2016	**6**	**13**	**10**	**3**	**3**	**0**

* The figures relate to decisions from previous years, but BaFin only came to know about them in the years specified in the left table column.

perpetrator's degree of fault minor and there was no public interest in criminal prosecution. Another 50 investigations (previous year: 49) were discontinued in accordance with section 153a of the Code of Criminal Procedure, after the defendants had paid an administrative fine.

In a further 28 proceedings (previous year: 16), the public prosecutors' offices concentrated on substantively more serious allegations and discontinued the market manipulation proceedings in accordance with section 154 or section 154a of the Code of Criminal Procedure.

Selected cases

Swiss FE Group AG and others

In a leading decision of 25 February 2016[23], the Federal Court of Justice (*Bundesgerichtshof*) confirmed a criminal conviction of the Regional Court (*Landgericht*) of Kleve of 7 November 2014. The Regional Court of Kleve had sentenced the former member of the management board of a securities trading bank in North Rhine-Westphalia, which has since been wound up, to a prison term of three years and three months, because this individual had violated the ban on market manipulation by using scalping. In 2006 to 2008, he had recommended the shares of Swiss FE Group AG, Metriopharm AG and Prime Beteiligungen AG without disclosing his own shareholdings. This is the first court ruling on scalping that relates not only to recommending shares through e-mailed market letters and an Internet portal, but also through telemarketing by a call centre. The public prosecutor's proceedings had been prompted by a complaint filed by BaFin in 2010.

The Federal Court of Justice ruled that the definition of "other acts of deception" as a criminal act within the meaning of section 20a (1) sentence 1 no. 3 of the Securities Trading Act, old version, was in accordance with the principle of legal clarity in the German Basic Law (*Grundgesetz*). With

23 Case ref. 3 StR 142/15.

regard to the effect on the share price within the meaning of section 38 (2) no. 1 of the Securities Trading Act, old version, the Federal Court of Justice determined in principle that the necessary extent of factual findings depended on the circumstances of the individual case. Sufficient evidence can be provided by making comparisons of the share price performance and trading volume to date, the share price performance and changes in trading volumes for the security in question on the day the act constituting the offence was committed, as well as the order size. If, therefore, there is only a short interval between sending out recommendations for relatively unknown shares and a rapid increase in trading volume and buyer numbers, it is very likely that there is a link between the recommendation and price fixing. This conclusion manifests itself if no other causes can be identified to which the performance could be attributed.

The Federal Court of Justice rescinded the judgement of the Regional Court of Kleve relating to issue of forfeiting compensation and referred the case back to a different criminal division of the Regional Court of Kleve for a new trial and decision.

Various funds

A judgement of the Regional Court of Frankfurt of 6 May 2016[24] became final on 14 May 2016. In this judgment, a securities trader operating in Frankfurt am Main at the time of the crime was given a suspended prison sentence of one year and eight months for 365 cases of market manipulation in coincidence with breach of fiduciary duty.

The trader worked as lead broker and specialist at the Frankfurt Stock Exchange. He engaged in wash trading to the disadvantage of his employer, a securities trading bank. First, he placed sell orders on the exchange in the name of the bank in order to subsequently accept them through private buy orders with a corresponding volume and price. He instructed these buy orders by using his wife's securities account. He then initiated private sell orders on the exchange and accepted them in the name of the bank when issuing corresponding offsetting buy orders.

He caused losses for the bank through these pre-arranged trades, because the bank bought the securities back at higher prices, thus generating a corresponding profit for the private securities account. The loss incurred by the bank amounted to approximately € 105,000.

He continued to practice this crime model even after his business unit, and thus his employment contract, had been transferred from one securities trading bank to another, with the result that the second bank incurred a (further) loss of approximately € 107,000.

BaFin had filed a complaint with the public prosecutor's office in Frankfurt in September 2010.

JK Wohnbau AG (now ISARIA Wohnbau AG)

On 13 January 2016, the Local Court (*Amtsgericht*) of Munich imposed a final administrative fine of € 55,000[25] on ISARIA Wohnbau AG in accordance with section 30 of the German Act on Breaches of Administrative Regulations (*Ordnungswidrigkeitengesetz*) for market manipulation, among other offences. The property developer had provided false information and failed to meet the deadline for publishing three financial reports for 2011.

The company's CEO at the time had already been sentenced to a prison term of three years and six months in 2013 by the Regional Court of Munich I for fraud and breach of fiduciary duty in connection with the IPO of JK Wohnbau AG. The court dealt with simultaneous violations of the ban on market manipulation in accordance with section 154 (1) and (2) of the Code of Criminal Procedure.

The Munich I public prosecutor's office discontinued the investigations into four other individuals because of suspected market manipulation and other offences in return

24 Case ref. 7521 Js 232742/10.

25 Case ref. 565 Js 111231/12.

for payments of €35,000, two amounts of €25,000 and €7,500 as part of out-of-court settlements in accordance with section 153a of the Code of Criminal Procedure. The individuals included a former CFO at JK Wohnbau AG, a management board member of a private bank domiciled in Berlin and the CEO of a media company for financial information in Kulmbach.

BaFin had filed a complaint with the public prosecutor's office in Munich I in January 2012.

Pfleiderer AG

In another court case about market manipulation in response to a criminal complaint filed by BaFin, the Local Court of Chemnitz convicted the defendant and handed down a suspended prison term of eight months in a final judgement in July 2015.[26]

Under a false identity, the convicted individual had disseminated incorrect positive information about Pfleiderer AG on specialised financial online portals in September 2012. A few days before this information was published, the convicted individual had acquired a considerable number of shares of the company. As intended, the share price rose sharply on the two exchange trading days following publication – by an accumulated total of almost 200 % at its peak. The convicted individual took advantage of the rise in demand by reselling his shares through several securities accounts within a single trading day, generating a profit totalling approximately €16,000. The short time span between the transactions and the profit generated as a result had drawn BaFin's attention to the convicted individual.

BaFin had filed a complaint with the public prosecutor's office in Chemnitz in May 2014.

Diskus Werke AG

A sentence handed down by the Local Court of Frankfurt am Main became final on 29 July 2016, imposing a total fine of 120 daily units on the convicted individual for six separate acts of market manipulation in trading in shares of Diskus Werke AG.[27] The daily units amounted to €230, resulting in a total of €27,600.

Between November 2009 and February 2010, the convicted individual used various securities accounts in Germany and abroad to place orders for shares of Diskus Werke AG, which he arranged in such a way that they could be offset against each other. During the period the crime was committed, the defendant was the chairman of the company's supervisory board and also in other respects traded through various securities account which belonged to Diskus Werke AG as a company and to its employees. Not only did he cause a rise in the share price, he alone was at times also responsible for the entire Xetra trading volume, thus having a significant influence on trading.

The public prosecutor's proceedings had been prompted by a complaint filed by BaFin in 2014.

2.3 Insider trading

Investigations

In 2016, BaFin launched 42 new investigations due to suspected insider trading (previous year: 43; see Table 21 "Insider trading investigations" on page 181). In 54 cases, it involved supervisory authorities abroad (previous year: 32), while in turn it dealt with 35 requests from foreign authorities (previous year: 19).

BaFin filed 21 complaints (previous year: 26) against a total of 49 suspects (previous year: 87) with the relevant public prosecutor's office. In 23 cases, it did not find any evidence of insider trading (previous year: 19).

39 investigations, some of which had been initiated in prior years, had not been completed by the end of 2016 (previous year: 41).

26 Case ref. 350 Js 21590/14.

27 Case ref. 7561 Js 217005/14.

Table 21 Insider trading investigations

Period	New investigations	Investigation results			Ongoing investigations
		Investigations discontinued	Investigations referred to public prosecutors' offices		
	Insiders	Insiders	Cases	Individuals	Total
2014	50	11	22	45	43
2015	43	19	26	87	41
2016	**42**	**23**	**21**	**49**	**39**

Table 22 Completed insider trading proceedings

Period	Total	Investigations discontinued	Investigations discontinued as part of out-of-court settlements	Final court judgements			
				Court judgements	Convictions following summary proceedings without trial	Convictions following full trial	Acquittals
2014	46	39	5	1	1	0	0
2015	41	31	8	1	1	0	0
2016	**93**	**75**	**14**	**3**	**1**	**0**	**0**

Sanctions

One individual was convicted of insider trading in 2016 (see Table 22 "Completed insider trading proceedings"). Cases against 89 individuals were discontinued by the public prosecutors' offices, 14 of them as part of out-of-court settlements. Insider trading and in particular the communication of inside information are difficult to prove. BaFin therefore supports the prosecuting authorities, for example by providing expert reports, delegating experts or accompanying searches.

Selected cases

Singulus Technologies AG

On 5 October 2016, a sentence[28] for insider trading became final, which the public prosecutor's office in Stuttgart had handed down on 25 May 2016 to the spouse of an employee of a subsidiary of Singulus AG. A fine of 200 daily units of €100 each was imposed, amounting to €20,000 in total. In addition, an amount of €24,380.85 was ordered forfeited as compensation.

On 12 September 2013, Singulus Technologies AG published an ad hoc disclosure, in which it reported that on that day it had entered into a master agreement with Zhejiang Fortune Photovoltaic Co. Ltd. M-Cells, a Chinese manufacturer of solar cells, for the supply of 16 plants for the production of solar cells. In response, the Singulus share price rose by 15%.

On the two days preceding this disclosure, the employee's spouse had bought a total of 210,000 shares of Singulus Technologies AG worth €315,719.15 in three transactions. As early as 13 September 2013, this individual sold all the shares again, generating a gross profit of €24,380.85 in this way.

The public prosecutor's proceedings were prompted by a complaint filed by BaFin in 2014.

Roth & Rau AG

Another case of insider trading proceedings was discontinued by the public prosecutor's office

28 Case ref. 155 Js 116120/14.

in Stuttgart on 12 September 2016 against payment of €25,000 as part of an out-of-court settlement.[29] The decision became final on 26 September 2016.

On 22 April 2011, the Swiss company Meyer Burger Technology AG submitted a takeover bid to the shareholders of the German company Roth & Rau AG. The intended cash offer price of €22 was 11.4% above the last price quoted for Roth & Rau shares, in response to which the share price rose by as much as 12.91%.

Shortly before the takeover was reported, the defendant had bought several tranches of call warrants on the underlying Roth & Rau AG shares with a total volume of €6,340.24. He sold these warrants for €21,120.60 immediately after the publication of the report and thus made a profit of €15,293.50. An unknown individual had previously informed the defendant of the imminent takeover. The public prosecutor's proceedings were prompted by a complaint filed by BaFin in 2013.

Bilfinger SE

Another case was discontinued against payment as part of an out-of-court settlement[30], amounting to €20,000 this time, thus ending insider trading proceedings on 30 June 2016 which BaFin had reported to the public prosecutor's office in Frankfurt am Main in 2015. The decision to discontinue the proceedings became final on 7 September 2016.

At 6.27 p.m. on 22 April 2015, Bilfinger SE issued an ad hoc disclosure to report that the first three months of the 2015 financial year had been disappointing for Bilfinger. On the basis of preliminary figures, adjusted EBITA[31] amounted to -€8 million (previous year: €47 million). In response, Bilfinger SE's share price decreased by 17.8%.

Also on 22 April 2015, but at 2.58 p.m. already, the CFO of a subgroup of Bilfinger SE bought 57,140 put warrants on the underlying Bilfinger SE shares with a volume of €19,999. She sold them on the following day, generating a profit of €26,855.80.

2.4 Ad hoc disclosures and managers' transactions

2.4.1 Ad hoc disclosures

In 2016, issuers published a total of 1,755 ad hoc disclosures (previous year: 1,434; see Figure 12 "Ad hoc disclosures and exemptions" on page 183). Although the number of ad hoc disclosures continued to decline until the middle of 2016, it rose sharply in the second half of the year. This is because the MAR expanded the legal scope of the obligation to publish inside information. In line with the rise in the number of ad hoc disclosures, the number of exemption notifications also increased considerably (403; previous year: 324). The number of administrative procedures used to pursue evidence of violations of the publication obligation, also grew in 2016 compared with the previous year. The focus was primarily on MTF issuers, which are required for the first time to meet legal transparency obligations, such as the publication of inside information. In this context, they have to comply not only with numerous European provisions based on the MAR and the accompanying Delegated Regulation (EU) 2016/522 and Implementing Regulation (EU) 2016/1055, but also continue to be subject to the national provisions of the Securities Trading Act and the German Securities Trading Reporting and Insider List Regulation (*Wertpapierhandelsanzeige- und Insiderverzeichnisverordnung*).

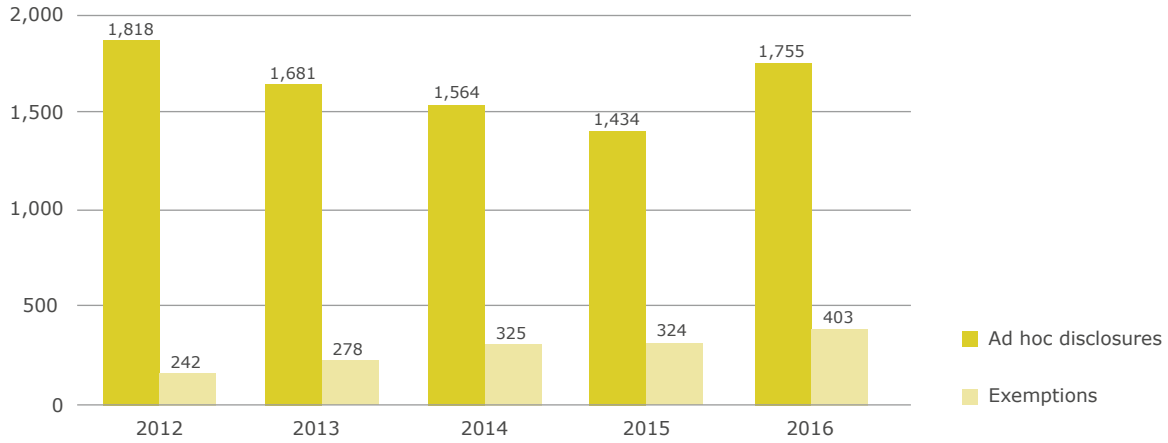
The implementation of the MAR, the adoption of the accompanying Implementing Regulations and Delegated Regulation and the application of the ESMA guidelines created considerable uncertainty in the capital market. This is evidenced in particular by numerous questions about interpretive issues received by BaFin. This involved queries about which authority had a particular duty

29 Case ref. 154 Js 89004/11.

30 Case ref. 7561 Js 241440/15.

31 Earnings before interest, taxes and amortisation.

Figure 12 Ad hoc disclosures and exemptions

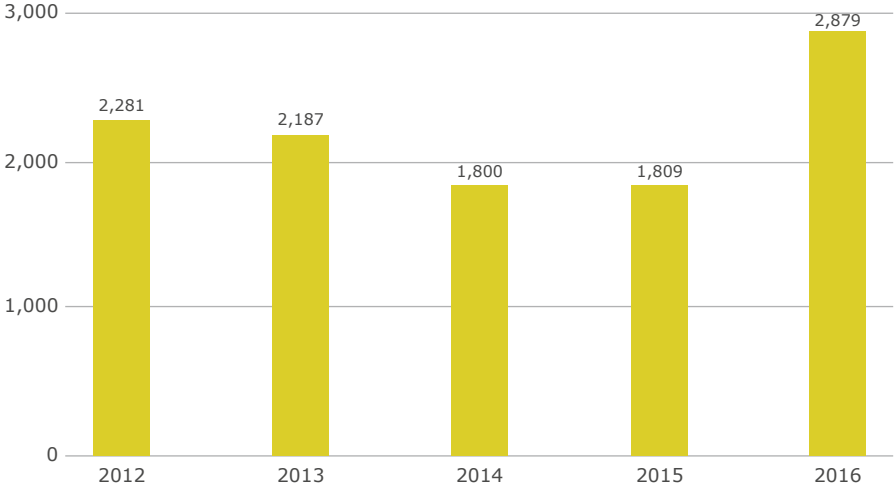


of supervision within the EU, whether the substance of the publication obligation still applied, or whether the individuals concerned have to submit the notification to BaFin in a different way. In order to deal with the volume of queries and the rise in the number of administrative procedures, especially in relation to MTF issuers, BaFin held four workshops from November to December 2016 at which it provided information on the MAR transparency obligations for MTF issuers.

2.4.2 Managers' transactions

Members of management boards or supervisory boards of issuers admitted to a regulated market or an MTF as well as persons closely related to such individuals reported a total of 2,879 securities transactions in 2016 (previous year: 1,809; see Figure 13 "Managers' transactions"). One reason for this significant increase is that the catalogue of transaction types and financial instruments has been expanded. For example, donations and debt instruments are now also subject to the notification requirement. Another factor is the extension of the notification obligation to include MTF issuers, which have since 3 July 2016 also been subject to the obligation to report managers' transactions, if they have filed their own application for admission to an MTF.

Figure 13 Managers' transactions



2.5 Monitoring of short selling

Prohibitions

In 2016, BaFin examined a total of 97 cases (previous year: 185) for compliance with the prohibition on naked short selling and certain transactions in credit default swaps (CDSs). The investigations, some of which were conducted in response to complaints filed by market participants, related to sales made by both companies and private individuals.

BaFin discontinued 78 investigations (previous year: 148), most of which 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 the end of 2016, the investigation of 8 cases had not yet been completed (previous year: 17); of this total, 2 date from 2015 and 6 from 2016. BaFin referred another 11 cases to other EU authorities for reasons of competence (previous year: 17). 11 cases were pursued further in administrative fine proceedings (previous year: 4).

Transparency requirements

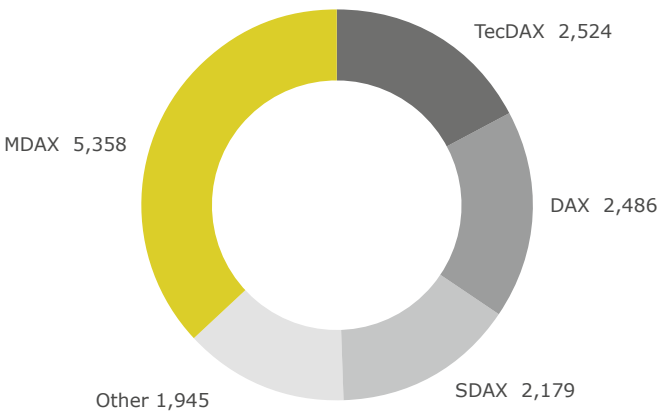
331 parties subject to the notification requirement (previous year: 289), as in the previous years mainly from the United Kingdom and the USA, notified BaFin in 2016 of a total of 14,492 net short positions (previous year: 13,525) in 249 different shares (previous year: 234). This corresponds to an average of 57 notifications per trading day. A total of 4,151 notifications (previous year: 4,074) had to be published in the Federal Gazette in 2016, because the threshold of 0.5 % of the share capital in issue had been crossed or reached. In addition, BaFin received 94 notifications for federal government debt securities (initial threshold: 0.5 %), slightly more than in the previous year (67 notifications). By contrast, as in the previous year, there were no notifications for debt securities of the federal states in 2016 (initial threshold: 0.1 %). As in previous years, net short positions were built in shares on the regulated market (see Figure 14 "Notifications broken down by index").

BaFin investigated 61 violations of the transparency requirements for net short positions in 2016 (previous year: 58). It discontinued a total of 25 investigations (previous year: 29). 18 were still pending at the end of 2016 (previous year: 28), 5 of them relating to 2014, 8 to 2015 and 5 to 2016.

2.6 Supervision of OTC derivative transactions

Six trade repositories were authorised in the EU at the end of 2016. Since February 2014, EMIR has required counterparties and

Figure 14 Notifications broken down by index



central counterparties to report to these trade repositories when derivative contracts are entered into, amended, or terminated. The reporting requirement applies to both OTC and exchange-traded derivative transactions. Together with ESMA and the other European supervisory authorities, BaFin is working to improve the quality of the data in order to enhance their usefulness.

Since 21 June 2016, there has been a requirement for market participants that are already members of a CCP to have standardised derivatives cleared centrally; this applies to certain interest rate derivatives in the four benchmark currencies (US dollar, euro, yen and sterling). This clearing obligation will gradually be extended to other market participants and derivative classes in the coming years. In this context, BaFin assessed whether the requirements were being met as and when needed. This process revealed that transactions had often been categorised ambiguously or incorrectly, thus making it seem as though the clearing obligation had been breached.

Since the clearing obligation came into force, the companies affected have also had the option to get exemption from the clearing obligation for transactions conducted within a consolidated or supervisory group. BaFin received a total of 140 notifications and applications to this effect in 2016 (see Table 23).

As part of its market surveillance, BaFin conducted risk-based investigations to establish to what extent financial counterparties, such as insurance undertakings, investment firms, banks and funds, comply with the requirements for OTC derivative transactions. Under section 20 of the Securities Trading Act, non-financial counterparties whose derivative position exceeds certain thresholds are required to provide evidence that they comply with the key requirements of EMIR by producing an auditor-issued certificate. Where any deficiencies were identified, BaFin investigated further (41 cases in 2016).

In addition, Commission Delegated Regulation (EU) 2016/2251 entered into force on 4 January 2017, providing further details of the requirement to collateralise bilateral OTC derivative transactions.[32] Under this regulation, financial counterparties and non-financial counterparties whose volume of derivatives exceeds a certain threshold have to provide collateral for non-centrally cleared OTC derivative contracts.[33] In 2016, BaFin accompanied the market participants as they implemented the provisions and discussed relevant interpretive issues with the companies and at the European level.

Table 23 Notifications and applications

	Notifications/ applications
Total no. of notifications/ applications	**140**
Both counterparties domiciled in Germany	16
One counterparty domiciled in other EU member state	40
One counterparty domiciled in third country	84

2.7 Voting rights

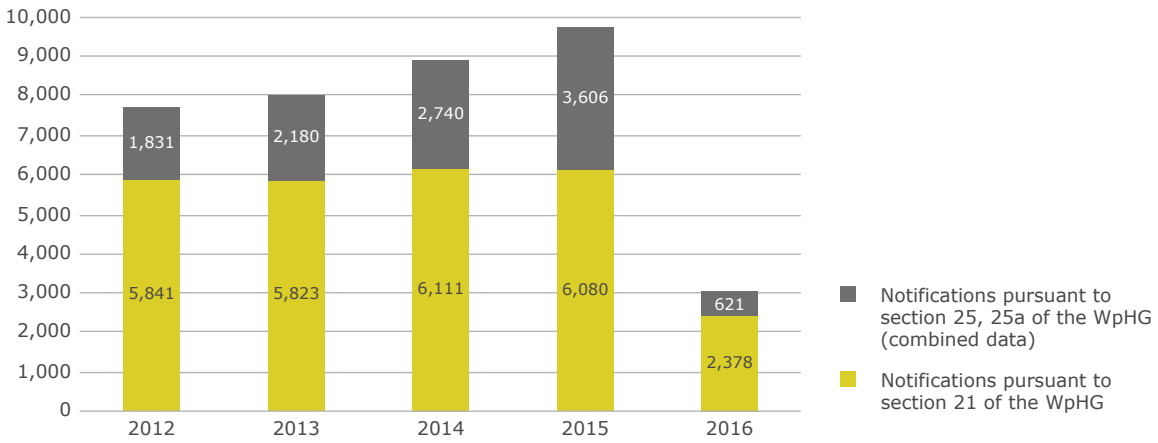
The number of changes in voting interests declined significantly in 2016 (2,378; previous year: 6,080; see Figure 15 on page 186). Likewise, the number of notifications on financial and other instruments – such as call options with physical or cash settlement and rights of redemption under securities loans – received pursuant to sections 25, 25a of the Securities Trading Act decreased significantly for the first time (621; previous year: 3,606).

BaFin received a total of 2,999 (previous year: 9,686) notifications pursuant to sections 21, 25 and 25a of the Securities Trading Act and monitored their publication.

32 Delegated Regulation (EU) No 2016/2251, OJ EU L 340, page 9 dated 15 December 2016.

33 For details, see 1.8.2.

Figure 15 Voting rights notifications



The significant decrease in the number of notifications is attributable to the German Act Implementing the Transparency Directive Amending Directive (*Umsetzungsgesetz zur europäischen Transparenzrichtlinie-Änderungsrichtlinie*), which entered into force on 26 November 2015. Since then, it has been possible, for example, to submit voting rights notifications by way of group notifications. As a result, in 2016, 1,954 of the total of 2,999 notifications were pure group notifications. In practice, this means that the ultimate parent undertaking can report changes in or levels of equity interests in a single voting rights notification. This notification exempts all subsidiaries from their notification obligations. The law (section 24 of the Securities Trading Act in conjunction with section 17 (2) of the Securities Trading Reporting and Insider List Regulation) does not restrict this way of submitting the notification to groups under stock corporation law, but permits a single notification for all parent-subsidiary relationships (section 22a (1) of the Securities Trading Act). The fact that there are fewer notifications within a group makes them all the more complex, thus increasing the examination effort at BaFin.

Another reason for the significant decrease is that the system of notification criteria had been changed. Each relevant change in interests held now triggers the disclosure of all shares and instruments to which voting rights are attached. This renders additional separate notifications obsolete, which had in certain circumstances been required under the old notification system.

The number of companies admitted to trading on the regulated market declined further, from 657 in the previous year to 614 in 2016. The number of notifications these companies published on changes in their voting share capital also decreased to 265 (previous year: 350). 4 real estate investment trusts (REITs) were subject to the reporting requirement at the end of 2016.

3 Prospectuses

3.1 Securities prospectuses

BaFin approved a total of 1,839 securities prospectuses, registration documents and supplements in 2016. This was a slight increase in the number of approvals compared with the previous year (1,810; see Table 24 "Number of approvals" on page 187). There were two cases in which BaFin declined to grant approval.

Table 24 Number of approvals in 2016 and 2015

Product	2016	2015
Shares (IPOs/capital increases)	68	86
Derivative products	314	260
Debt securities	153	181
Registration documents	33	32
Supplements	1,271	1,251
Total	**1,839**	**1,810**

A decrease can be observed in the number of prospectuses for shares (IPOs and capital increases) and debt securities. After peaking in 2015 (86), the number of share prospectuses (68) dropped below the 2014 level (69).

A slightly positive trend can be observed for derivative products. These prospectuses normally relate to the certificate programmes of large issuers (banks, savings banks), which subsequently also apply to public offers for a 12-month period. The total number of base prospectuses increased and, in line with it, the number of supplements also rose. Most supplements are approved for the base prospectuses of large issuers in order to keep them up to date during the period of validity of the prospectuses. The total number of final terms decreased from 3,436,840 in 2015 to 3,260,884.

The number of notifications BaFin transmitted to other national supervisory authorities under the European Passport continued to rise in 2016 (3,935; previous year: 3,436). This related primarily to prospectuses notified to Austria and Luxembourg. By contrast, the number of notifications received decreased significantly to 849 (previous year: 1,298). At almost 60 %, most of them again came from Luxembourg.

The total issue volume in 2016 was 3,260,986, the first slight decline after a series of increases, although it was higher than the 2014 figure (see Figure 16 "Total issue volume").

3.2 Non-securities investment prospectuses

As the trend at the end of 2015 had suggested, the number of non-securities investment prospectuses continued to increase in 2016. This was mainly because the transitional period during which certain investment products, such as profit participation loans, subordinated loans and direct investments, did not require a prospectus expired at the end of 2015. A total of 179 non-securities investment prospectuses

Figure 16 Total issue volume

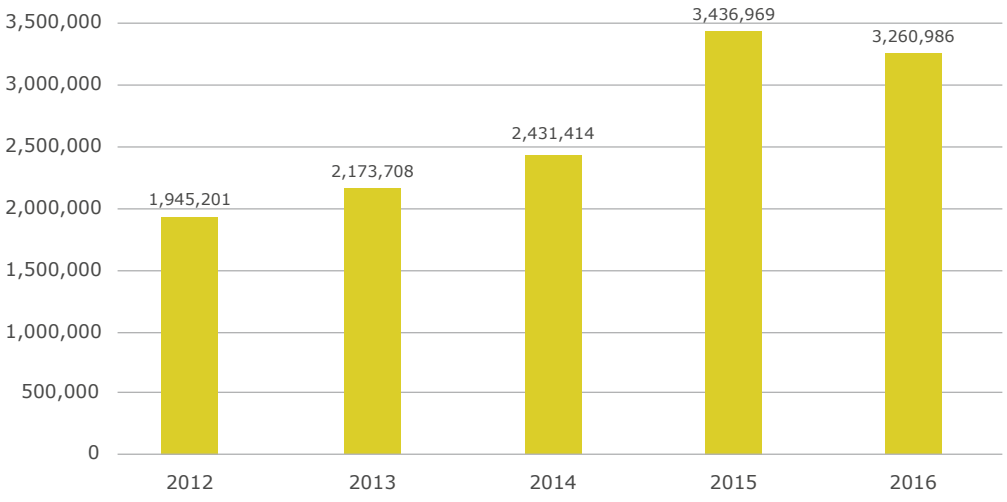
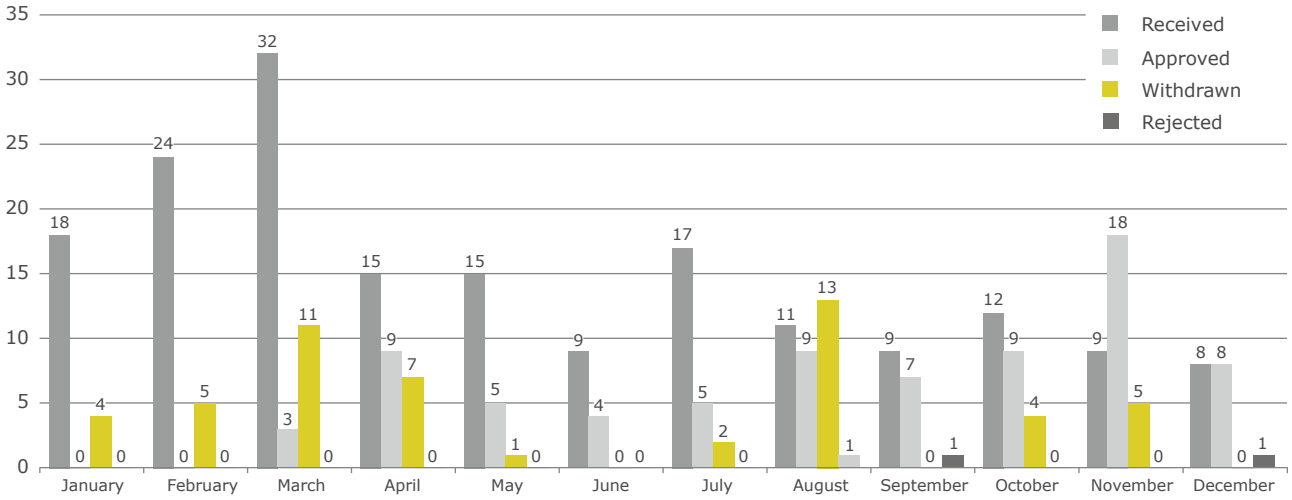


Figure 17 Prospectuses received, approved, withdrawn and rejected



were received for checking, up significantly from the 123 documents received in the previous year (see Figure 17). BaFin approved 77 prospectuses (previous year: 50).

In the breakdown by type of participation, subordinated loans – which have required a prospectus since the transitional period ended, i.e. since the beginning of 2016 at the latest – immediately occupied the top position, with 70 prospectuses received (approximately 39 %; see Figure 18 "Prospectuses by type of participation").

They beat participations in limited partnerships into second place, with 39 prospectuses received (approximately 22 %; previous year: approximately 48 %). They were followed by other investments (for example, direct investments in containers or tree plantations) within the meaning of section 1 (2) no. 7 of the German Capital Investment Act (*Vermögensanlagengesetz*), which are now also subject to the prospectus requirement; 31 prospectuses were received for these investments (approximately 17 %).

Figure 18 Prospectuses by type of participation

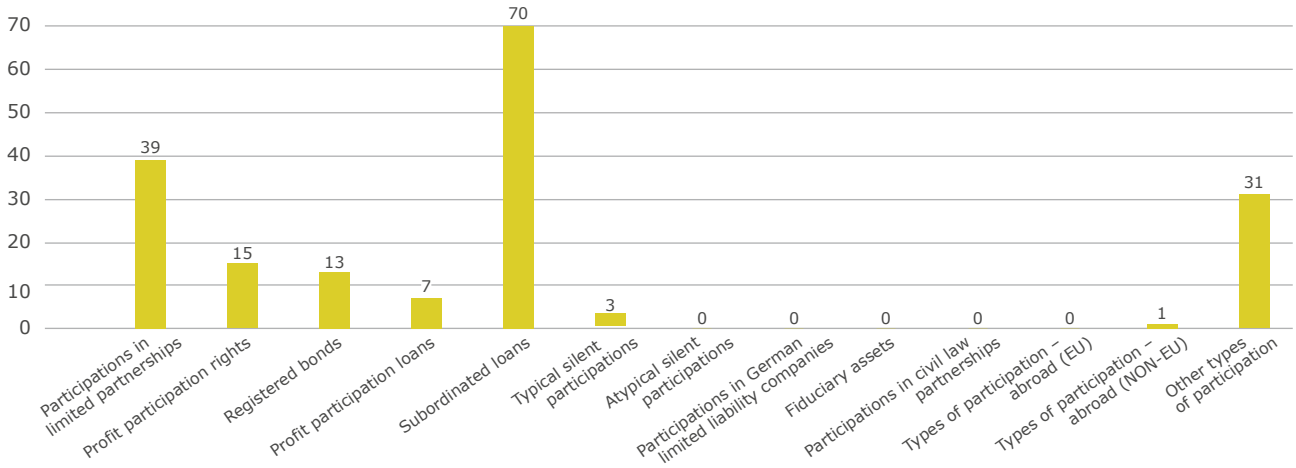
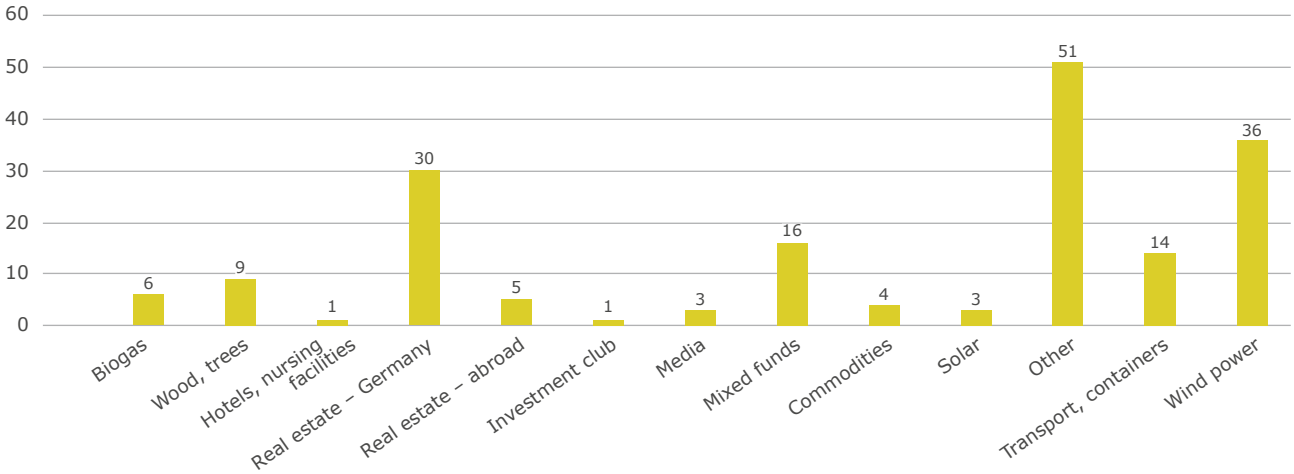


Figure 19 Prospectuses by target investment



In terms of target investments (see Figure 19 "Prospectuses by target investment") renewable energy (wind power, solar, biogas) again accounted for the largest proportion, with 45 prospectuses received (approximately 25 %; previous year: approximately 33 %). A total of 35 prospectuses were received in relation to real estate (in Germany and abroad), accounting for approximately 20 %, a sharp increase compared with the previous year (approximately 10 %). The new prospectus requirement for direct investments – in areas such as transportation, containers, wood and trees – gave rise to 31 prospectuses being submitted. 51 of the prospectuses received related to other target investments such as blind pool structures (28 %; previous year: 39 %), which therefore continue to represent a significant share alongside the traditional variants.

In 2016, a total of 24 applications for the approval of supplements under the Capital Investment Act were received, a decrease compared with 38 applications received in the previous year. BaFin approved 13 supplements in the year under review (previous year: 34).

Market surveillance of prospectus requirement

In order to enhance the transparency of capital investments, the Retail Investor Protection Act has expanded and defined in more detail the scope of the Capital Investment Act. Many financial products that issuers were previously allowed to offer without a prospectus now fall under the prospectus requirement. The aim is to provide better information and protection for investors. BaFin has monitored the market to this end since the beginning of 2016 through a separate organisational unit established specifically for this purpose. This unit investigated a total of 119 offers in 2016 to establish whether they meet the provisions of prospectus law. There were only two cases in which BaFin prohibited a public offer. In the vast majority of cases, the issuers opted to withdraw the offer after BaFin had made contact with them. In 20 out of a total of 35 cases, the pursuit of marketing violations related to missing or insufficiently prominent warnings in the marketing material for investments offered to the public. Most issuers understood the problem and adjusted their wording and design immediately to comply with the legal requirements.

The new exemption introduced by the German Retail Investor Protection Act (*Kleinanlegerschutzgesetz*) for crowdfunding specifies that public offers compliant with the requirements of section 2a of the Capital Investment Act may be conducted without a prospectus. However, issuers must submit a capital investments information sheet to BaFin before the public offer commences. In the year under review, 263 such capital investments information sheets were submitted for crowdfunding projects.

4 Company takeovers

Offer procedures

In 2016, BaFin checked a total of 22 offer documents (previous year: 19) and approved their publication in all cases (previous year: 18; see Figure 20 "Offer procedures").

Deutsche Börse takeover bid

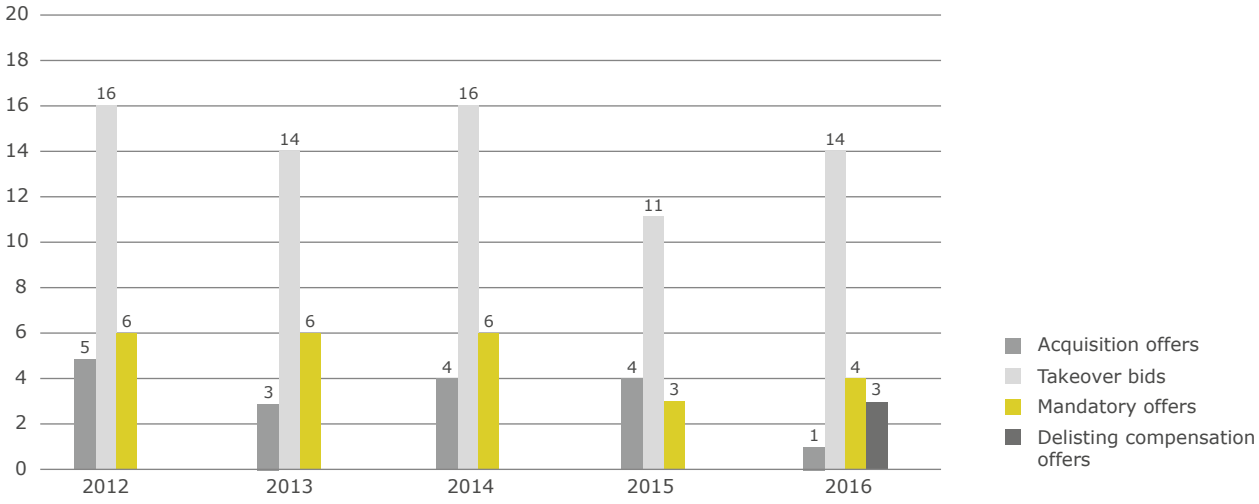
The planned merger of Deutsche Börse AG (DBAG) and London Stock Exchange Group plc (LSEG) generated much public interest in 2016. On 16 March 2016, the Executive Board of Deutsche Börse AG, with the consent of the Supervisory Board, published its decision to submit a takeover bid for London Stock Exchange Group plc in accordance with the UK City Code on Takeovers and Mergers (UK Code). According to these plans, the merger was to be achieved through a new holding company (UK TopCo) domiciled in London. Under the planned arrangement, the shareholders of DBAG would have held an interest of approximately 54.4 % and the shareholders of LSEG an interest of approximately 45.6 % in the share capital of the future joint company, UK TopCo. The European Commission prohibited the proposed merger in March 2017 in accordance with the EU Merger Regulation.

Delisting offer procedure

At the end of November 2015, new delisting rules entered into force in the form of the modified section 39 of the German Stock Exchange Act (*Börsengesetz*) (see info box on page 191). In 2016, BaFin clarified initial questions about application.

There was an atypical delisting offer in the first half of 2016: the offer submitted by LSREF4 ARIA Beteiligungs GmbH & Co. KG to the shareholders of ISARIA Wohnbau AG.

Figure 20 Offer procedures



New delisting rules

The new delisting rules in the modified section 39 of the Stock Exchange Act entered into force on 26 November 2015. Since then, issuers planning to delist their shares from the regulated market completely or to downlist them to the regulated unofficial market must submit a delisting compensation offer to the non-controlling shareholders in accordance with section 39 of the Stock Exchange Act in conjunction with the German Securities Acquisition and Takeover Act (*Wertpapiererwerbs- und Übernahmegesetz*). Unlike the already familiar acquisition offer in accordance with sections 10 et seq. of the Securities Acquisition and Takeover Act, securities are not eligible as consideration; instead, the delisting compensation offer must specify a cash amount in euros. What is more, the offer must not be made subject to any conditions. In addition, the minimum pricing provisions that are otherwise only mandatory for takeover bids and mandatory offers apply, subject to the proviso, among other factors, that they are based on a volume-weighted six-month average price. Moreover, the bidder has to ensure that the delisting will only take effect at the end of the acceptance period of the delisting compensation offer. Depending on the periods specified in the respective stock exchange rules and regulations, the delisting/downlisting application may therefore only have to be submitted at the end of the acceptance period.[34]

The bidder linked its takeover bid to a delisting compensation offer. In this context, BaFin clarified that a takeover bid or mandatory offer may be combined with a delisting compensation offer. Such a combined delisting offer must, however, meet the requirements of the delisting compensation offer, which are for the most part more stringent.

In the second half of 2016, there were three typical delisting compensation offers in each of which the issuer's major shareholder submitted an offer: the offers of Sachsenmilch Anlagen Holding GmbH to the shareholders of Sachsenmilch AG, of BDI Beteiligungs GmbH to the shareholders of BDI – BioEnergy International AG and of Amadeus Corporate Business AG to the shareholders of i:FAO Aktiengesellschaft.

In all the offers, the coordination between bidder and target company with regard to the offer procedure in accordance with the Securities Acquisition and Takeover Act and the delisting/downlisting application process at the respective stock exchange proceeded without any problems.

Exemption procedures

BaFin received 41 applications for exemption or non-consideration (previous year: 83). In 21 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: 31), while the other 20 applications for exemption were applications for exemption from the publication requirement and from the obligation to submit an offer in accordance with section 37 of the Securities Acquisition and Takeover Act (previous year: 52). BaFin approved 65 applications. 6 applications were withdrawn and 12 were still being processed at the end of 2016.

34 www.bafin.de/dok/7874236.

5 Financial reporting enforcement

Monitoring of financial reporting

The number of companies subject to the two-tier enforcement procedure by BaFin and the German Financial Reporting Enforcement Panel (*Deutsche Prüfstelle für Rechnungslegung* – FREP) again declined significantly in 2016 as against the previous year.[35] As at 1 July 2016, only 615 companies (previous year: 686) from 9 countries (previous year: 19) were affected. The decline is primarily attributable to the fact that open-ended funds are no longer supervised. In addition, the organised market recorded more delistings than new listings by companies whose securities are admitted to trading there. By contrast, the introduction of the home country principle did not have any significant impact (see info box).

The FREP completed a total of 96 examinations in 2016 (previous year: 81), of which 87 were sampling examinations. BaFin itself performed financial reporting enforcement procedures at 16 companies (previous year: 15) and ordered the publication of errors in 13 cases. In 9 of the 16 cases, the FREP had previously identified errors in agreement with the relevant companies (see Table 25 "Enforcement procedures" on page 193). The remaining 7 cases were based on error identification procedures performed by BaFin. In 4 of these cases, the companies had not accepted the FREP's findings, and in 3 cases the companies had refused to cooperate with the FREP.

A total of 4 of the 7 cases ended in error findings. For these 4 procedures, BaFin ordered the publication of the findings. These procedures related to various accounting issues, such as the understatement or overstatement of goodwill in 3 cases. The procedures relating to management and group management reports highlighted that the risks of future development had not been presented and that the forecast of future results of operations had been inadequate. 8 cases were still pending at BaFin at the end of 2016.

§

Home country principle

Since 1 January 2016, companies have been subject to the two-tier financial reporting enforcement procedure by BaFin and the Financial Reporting Enforcement Panel not only exclusively on the basis of the admission of securities to trading on an organised market in Germany, but also on the basis of 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 their securities are also admitted to trading on the organised market in Germany, but 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 (EEA). As a result, the number of foreign companies subject to German enforcement procedures declined.

By 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 Financial Reporting Enforcement Panel in Germany. As before, in special constellations, issuers also have the option to choose their home country. This is possible, for example, for issuers of shares whose registered office is in a third country and whose securities are admitted to trading on an organised market in Germany and on another organised market in the EU or an EEA signatory state.

35 See 2015 annual report, pages 246 ff.

Table 25 Enforcement procedures

	Error finding: yes	Error finding: no	Error publication: yes	Error publication: no
Companies accept FREP's findings	9		9	0
Companies do not accept FREP's findings	3	1	3	0
Companies refuse to cooperate with FREP	1	2	1	0
BaFin has material doubts as to the accuracy of the FREP's findings/procedure	0	0	0	0
Examination taken over by BaFin (banks, insurance undertakings)	0	0	0	0
Total	**13**	**3**	**13**	**0**

Legal certainty

A ruling of the Securities and Takeover Division of the Higher Regional Court (*Oberlandesgericht*) of Frankfurt am Main, the competent court of first and last instance, brought further legal certainty in 2016.

In proceedings to obtain interim relief, the Higher Regional Court explained that the criterion of considerable doubt within the meaning of section 37u (2) of the German Securities Trading Act (*Wertpapierhandelsgesetz*) and section 50 (3) no. 2 of the German Securities Acquisition and Takeover Act (*Wertpapiererwerbs- und Übernahmegesetz*) had to meet considerable requirements.[36] The existence of these considerable doubts could only be assumed, if the court considered it more probable than not that BaFin's administrative act would be reversed in the main proceedings following a summary examination. It was not sufficient, however, to claim that the legal basis was still uncertain. Moreover, just like in other areas of the law, interpretive issues in accounting legislation could not be left to the "discretion" of the party applying the law, but would have to be decided by the competent courts in binding rulings on disputes. The interpretation that the accounting was merely "justifiable" did therefore not provide sufficient grounds in interim relief proceedings.

Publication of financial reports

In 2016, BaFin examined in approximately 940 cases whether the issuers had published their online annual and half-yearly financial reports on time (previous year: 950). In 27 cases, it continued the examinations in administrative offence proceedings (previous year: 28).

In 2016, BaFin performed approximately 940 examinations in order to establish whether the issuers had met their financial reporting requirements (previous year: 950).

27 cases were referred to the BaFin division responsible for administrative offences because there were no financial reports. The compliance ratio is on a level with the previous year.

BaFin made it a main focus of its examinations to monitor the publication of notifications on annual financial reports. The publication of notifications is intended to provide timely information on when and where financial reports are published on the Internet. In 34 cases, issuers whose registered office is in Germany failed to publish these notifications; BaFin pursued these cases in administrative offence proceedings. What is more, in all the

36 Higher Regional Court of Frankfurt, decision of 7 January 2016, case ref. WpÜG 1/15, WpÜG 2/15.

above cases, the corresponding annual reports had not been published either. The publication of annual reports by issuers whose registered office is in Germany is monitored by the Federal Office of Justice (*Bundesamt für Justiz*).

Another main focus of its examinations was the completeness of financial reports. BaFin initiated administrative offence proceedings in 16 cases because the responsibility statements in accordance with section 37w (2) no. 3 and section 37w (2) no. 3 in conjunction with section 37y no. 2 of the Securities Trading Act had not been included in the half-yearly financial reports.

BaFin launched 13 administrative procedures to enforce the financial reporting requirements. A total of 14 proceedings were still pending from the previous year, and 13 proceedings were concluded by BaFin in 2016. During administrative proceedings, BaFin threatened coercive fines in 12 cases. It imposed coercive fines and initiated enforcement measures in 7 cases. Coercive fines were paid in 3 proceedings. In one of these proceedings, the coercive fine paid amounted to €260,000.

Following the entry into force of the German Act Implementing the Transparency Directive Amending Directive (*Umsetzungsgesetz zur europäischen Transparenzrichtlinie-Änderungsrichtlinie*), BaFin published measures it had imposed in order to ensure compliance with the financial reporting requirements on its website[37] for the first time in 2016. Seven measures were published there.

37 www.bafin.de/dok/7953854.

6 Supervision of the investment business

6.1 Asset management companies and depositaries

In 2016, BaFin authorised 14 asset management companies (*Kapitalverwaltungsgesellschaft*) to manage collective investment undertakings or extended their existing authorisation (previous year: 26). 2 companies surrendered their authorisation (previous year: 1). This meant that, at the end of 2016, 136 companies were authorised in accordance with the Investment Code (*Kapitalanlagegesetzbuch*) (previous year: 138). In addition, 50 asset management companies registered in accordance with section 44 of the Investment Code (previous year: 74). 8 companies surrendered their registration, 2 of which applied for authorisation in accordance with the Investment Code. The total number of asset management companies registered as at the end of 2016 stood at 260 (previous year: 218). In 11 cases, asset management companies established a branch in another EU member state or offered cross-border services (previous year: 18). A total of 25 companies from other EU countries notified BaFin that they had established a branch or started providing cross-border services in Germany (previous year: 19).

Risk-based supervision

BaFin performed a total of 102 supervisory visits and annual interviews on site (previous year: 90) using a risk-based approach (see Table 26 "Risk classification of management companies" on page 195). It accompanied 13 audits and special audits at asset management companies as well as at depositaries and trustees (previous year: 16).

In the third year since the introduction of the Investment Code, BaFin examined in particular how the asset management companies have implemented the comprehensive requirements in their day-to-day business operations. In this context, its analysis focused particularly on whether the new structures created by the companies proved useful with regard to the statutory conduct of business rules and organisational requirements. For example,

Table 26 Risk classification of asset management companies

Asset management companies		Quality				Total
		A	B	C	D	
Impact	High	7	2	0	0	**9**
	Medium	1	2	1	0	**4**
	Low	45	3	0	0	**48**
	Total	**53**	**7**	**1**	**0**	**61**

BaFin's examination of the risk management system of an asset management company also included an investigation of the specific investments made for a collective investment undertaking. These investment decisions must match the investment strategy and risk profile of the fund, and the asset management company has to review the decision by following a defined process.

BaFin examined in special audits whether the specific obligations for the depositary business had been met. The responsibilities of depositaries and trustees include, among other things, keeping the assets of a collective investment undertaking in safe custody, issuing and redeeming units and calculating unit prices. In this context, they also exercise a control function over the asset management companies.

In addition, BaFin revised the "Minimum requirements for the risk management of investment companies" (*Mindestanforderungen an das Risikomanagement für Investmentgesellschaften*) and issued a new version in Circular 01/2017 (WA) – "Minimum requirements for the risk management of asset management companies" (*Mindestanforderungen an das Risikomanagement von Kapitalverwaltungsgesellschaften* – KAMaRisk) – dated 10 January 2017. The main changes relate to amendments to bring the "Minimum requirements for the risk management of asset management companies" in line with Delegated Regulation (EU) No 231/2013 ("AIFM Level 2 Regulation")[38]. The AIFM Level 2 Regulation contains, among other things, directly applicable rules on organisational requirements, risk management and outsourcing of AIF management companies. The "Minimum requirements for the risk management of asset management companies" specify some of these provisions in greater detail. Only in the second instance should they be used to determine the "Minimum requirements for the risk management of asset management companies". Secondly, the minimum requirements for the risk management of asset management companies set out minimum requirements for the risk management of AIF management companies that grant loans for the account of the AIF or invest in unsecuritised loan receivables. These requirements are largely based on the rules applicable in the lending business contained in the banking supervisory "Minimum requirements for risk management" (*Mindestanforderungen an das Risikomanagement* – MaRisk) and have been adapted to the special requirements of collective investment management.

6.2 Collective investment undertakings

The German investment market continued to grow in 2016, with both special and retail funds recording cash inflows.

At the end of 2016, the asset management companies managed a total of 6,122 collective

38 Commission Delegated Regulation (EU) No 231/2013 of 19 December 2012.

investment undertakings (previous year: 5,649) with assets amounting to €1.908 billion (previous year: €1.743 billion). Of these funds, 2,194 (previous year: 1,777) were retail funds with assets totalling €451 billion (previous year: €427 billion) and 3,928 (previous year: 3,872) were special AIFs with assets of €1.457 billion (previous year: €1.316 billion).

Aggregate (net) cash inflows into retail and special funds amounted to €119.96 billion (previous year: €146.1 billion). (Gross) cash inflows amounted to €310.3 billion (previous year: €367.5 billion), of which €106.8 billion were attributable to retail investment funds (previous year: €137.3 billion) and €203.5 billion to special AIFs (previous year: €230.2 billion). This was set against total cash outflows amounting to €190.3 billion (previous year: €221.4 billion).

In 2016, BaFin approved a total of 151 new retail investment funds in accordance with the Investment Code (previous year: 230), including 99 UCITS (previous year: 121), 12 open-ended retail AIFs (previous year: 36) and 40 closed-ended retail AIFs (previous year: 73).

6.2.1 Open-ended real estate funds and hedge funds

As at the end of 2016, BaFin supervised a total of 46 asset management companies authorised to manage open-ended real estate funds (previous year: 45). One of the companies was granted its authorisation in 2016.

While 22 asset management companies had also established open-ended real estate funds for retail investors (previous year: 21), the other 24 companies (previous year: 24) had limited their activities to the management of open-ended real estate special funds.

7 open-ended real estate funds for retail investors were established in the course of 2016, increasing the number of these funds to 51 (previous year: 48). The fund volume of this market segment amounted to €89.48 billion as at the end of the year (previous year: €85.2 billion).

Gross cash inflows into open-ended real estate funds for retail investors increased again in 2016, to €7.9 billion (previous year: €7.0 billion). Gross cash inflows into open-ended real estate special funds increased for the sixth year in succession, to €14.9 billion (previous year: €13.0 billion). The fund assets of open-ended real estate special funds amounted to €75.6 billion at the end of 2016 (previous year: €64.5 billion).

20 open-ended real estate funds for retail investors were in liquidation at the end of 2016 (previous year: 19). Their fund volume amounted to €8.2 billion (previous year: €10.8 billion). The management rights for 14 of these funds have already been transferred to the depositary (previous year: 11).

There were 14 hedge funds in Germany at the end of 2016 (previous year: 24). The total volume under management was €3.02 billion (previous year: approximately €2.85 billion). As in 2015, there were no German funds of hedge funds in Germany.

6.2.2 Foreign collective investment undertakings

In 2016, there were 9,795 EU UCITS[39] authorised for marketing (previous year: 10.513). BaFin processed a total of 941 new notifications by companies wanting to market EU UCITS in Germany (previous year: 846). As in previous years, most of the notifications – 554 in total – came from Luxembourg. In addition, 274 notifications were received from Ireland, 39 from France and 39 from Austria. Marketing was discontinued for 607 EU UCITS.

In addition, 1,402 EU AIFs and 266 foreign AIFs from third countries were authorised to conduct marketing in Germany (previous year: 1,324 EU AIFs and 168 foreign AIFs from third

39 UCITS stands for „undertakings for collective investment in transferable securities". UCITS are funds that meet the requirements of Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities.

countries). Of the total number, 745 originated in Luxembourg, 254 in the United Kingdom, 214 in Ireland, 93 in the Cayman Islands, 83 in the United States, 111 in France, 11 in Switzerland and 38 in the Netherlands. In 2016, marketing for 525 AIFs (previous year: 486) started in Germany, including 204 from Luxembourg, 93 from the United Kingdom, 69 from Ireland, 26 from the Cayman Islands and 25 from the United States. 165 EU AIFs and foreign AIFs ceased marketing, including 49 from Luxembourg, 50 from the United Kingdom and 16 from Ireland.

6.2.3 Switch to the Act Implementing the UCITS V Directive

The UCITS V Directive[40] had to be transposed into national law by 18 March 2016. It amends the UCITS Directive in terms of the tasks performed by depositaries, remuneration policies and sanctions. The Act Implementing the UCITS V Directive entered into force on that date, and the asset management companies had until then to adapt the fund rules of existing UCITS to the new requirements, submit the relevant approval applications to BaFin and have them approved.

Legal basis only created by implementing act

However, the legal basis for approving amended fund rules was only created when the Act Implementing the UCITS V Directive entered into force, which only happened one week before the deadline for making the switch. The Act Implementing the UCITS V Directive had limited the extent of permissible modifications to those required for editorial reasons or to adapt the legislation to the new requirements. Yet the need to process the amendment applications of more than 40 asset management companies for almost 1,400 UCITS in total within just one week posed challenges for both the industry and BaFin alike.

For this reason, BaFin and the Bundesverband Investment und Asset Management e.V. (BVI) began in good time to consult on and agree sample fund rules reflecting the required amendments. This allowed the companies affected to get information about the planned submission and approval process as early as at the end of 2015. In addition, agreed sample fund rules were available in good time before the application needed to be submitted and the Act Implementing the UCITS V Directive entered into force.

Due to amendments to the German Investment Tax Act (*Investmentsteuergesetz*), which are expected to enter into force on 1 January 2018, it is foreseeable that the sample fund rules will have to be amended again. BaFin is already in consultation with the BVI about this.

6.2.4 Shadow banking and financial stability in asset management

BaFin is actively involved in the international discussions around the shadow banking sector/system and financial stability in the asset management sector.

Financial Stability Board (FSB)

At their meeting in Cannes in 2011, the G20 heads of state and government resolved far-reaching measures to strengthen financial stability. In addition to tighter regulation of the banking sector in response to the financial crisis, they resolved to investigate regulatory loopholes in other parts of the financial system and to act on any findings. The G20 asked the Financial Stability Board, in cooperation with the standard-setting bodies, to draft, among other things, recommendations for improving the supervision and regulation of the global shadow banking sector. In this context, the FSB developed international recommendations to address the structural vulnerabilities from asset management activities in the collective investment undertaking/asset manager segment. The in total 14 proposed policy recommendations cover liquidity mismatch, leverage, operational risks and risks associated with securities lending.

40 See 1.6.

The FSB finalised and adopted the recommendations at the beginning of 2017.

The G20 finance ministers confirmed the recommendations in March. The International Organization of Securities Commissions (IOSCO) was instructed to implement the recommendations as far as possible by the end of 2017.

6.3 European Systemic Risk Board (ESRB)

The Expert Group on Shadow Banking, which works under the auspices of the European Systemic Risk Board monitors structural changes in the European shadow banking sector as well as risks from EU shadow banking activities. The expert group is made up of representatives of central banks and supervisory authorities. Its work complements global initiatives, especially those of the FSB, in this area. The group publishes an annual shadow banking monitoring report, which contains measured quantities and analysis relating to this issue. The methods used in the report are to be enhanced over time and supervision data provided by national supervisors is to be added.

7 Administrative fine proceedings

7.1 Administrative fines[41]

In 2016, BaFin launched 281 new administrative fine proceedings due to violations of capital markets law (previous year: 421; see Table 27 "Administrative fine proceedings" on page 199). A total of 1,041 proceedings were still pending from the previous year. BaFin concluded 106 proceedings (previous year: 180) by imposing administrative fines totalling €2.57 million (previous year: €7.2 million). The prosecution ratio was 27.6 % (previous year: 37.8 %). BaFin discontinued a total of 289 administrative fine proceedings, 194 for discretionary reasons.

7.2 Selected cases

Intentional violation of obligation to publish ad hoc disclosures

In response to an MDAX company's intentional failure to publish inside information in a timely manner, BaFin imposed an administrative fine of €195,000. Although the company had considered the need to change the forecast and issue a profit warning to be inside information, it failed to publish this information without undue delay. Instead, the company published the ad hoc disclosure only several trading days after the text had been prepared internally and released for publication.

Violation of financial reporting requirements

In response to a domestic issuer's intentional failure to publish two half-yearly financial reports in a timely manner, BaFin imposed a total administrative fine of €186,000. The company subsequently published the reports with a delay of several months. In the company's opinion, it was not possible to publish the two reports because insolvency proceedings had been opened in the meantime. It was therefore not clear whether the company's financial reports would have to be prepared on a going concern basis or for a discontinued operation. However, there were no provisions in accounting law that prevented the timely preparation and publication of the reports. The company was aiming, under protective shield proceedings, to develop a

41 For administrative fine proceedings due to violations by investment firms of the conduct of business rules as well as organisational and transparency requirements under the Securities Trading Act and violations of the Banking Act, see chapters II 1.5.3 and II 3.2.

Table 27 Administrative fine proceedings

	Proceedings pending at the beginning of 2016	New proceedings initiated in 2016	Administrative fines*	Highest administrative fine imposed** (€)	Proceedings discontinued for		Proceedings pending at the end of 2016
					factual or legal reasons	discretionary reasons	
Reporting requirements (section 9 of the Securities Trading Act)	5	7	3	25,000	0	0	9
Ad hoc disclosures (section 15 of the Securities Trading Act)	81	21	13	195,000	0	7	82
Managers' transactions (section 15a of the Securities Trading Act)	6	1	0	0	0	1	6
Market manipulation (section 20a of the Securities Trading Act)	27	14	0	0	3	2	36
Notification and publication requirements (sections 21 *et seq.* of the Securities Trading Act)	692	152	75	120,000	65	137	567
Duties to provide information to securities holders (sections 30a *et seq.* of the Securities Trading Act)	50	10	5	16,500	8	10	37
Short selling (section 30h of the Securities Trading Act)	6	7	1	35,000	0	0	12
Financial reporting requirements (sections 37v *et seq.* of the Securities Trading Act)	109	59	6	93,000	17	14	131
Securities Prospectus Act	12	7	0	0	0	0	19
Capital Investment Act/Prospectus Act	8	2	2	12,000	1	1	6
Company takeovers (Securities Acquisition and Takeover Act)	42	0	1	5,500	1	22	18
Other	3	1	0	0	0	0	4

* Proceedings completed by imposing an administrative fine.
** Individual administrative fines.

Information published on BaFin's website

BaFin publishes on its website information on measures and sanctions imposed by Securities Supervision.[42] This new practice has resulted from new European requirements laid down in the Transparency Directive II[43] and the MAR[44]. Apart from a few exceptions, the information is published immediately and not anonymised. In addition to the identity of the affected party, the information published includes above all the type of violation, the legal provisions contravened and the type of measure or sanction imposed. The measures or sanctions imposed do not have to be enforceable as a condition for publication; rather, the information has to be published immediately following the decision. For this reason, BaFin continually updates the information published on its website to reflect the status of the proceedings. For example, if an affected party appeals, BaFin will add a note to the information published. BaFin can only delay or anonymise the information published in narrowly defined exceptional cases, for example if it would be disproportionate to publish personal data. For violations of the MAR, BaFin can also – as a last resort – opt not to publish the information at all. The MAR specifies that the information must be available on BaFin's website for a period of at least five years. Section 40d of the German Securities Trading Act (*Wertpapierhandelsgesetz*) additionally specifies that the information must be deleted after that period.

recovery plan and subsequently implement the plan in insolvency proceedings under self-administration. There were no indications that the recovery plans could not reasonably be expected to be successful. The accounts could therefore have been prepared on a going concern basis.

In any event, a company has to meet its financial reporting requirements even if it is uncertain that it will continue as a going concern. The provisions containing the financial reporting requirements do not allow for any exception or exemption criteria for companies in financial difficulty. Timely reports are of key importance for investors, especially when a company faces a crisis.

Violations of reporting requirements

BaFin imposed an administrative fine of €25,000 on a financial services institution whose registered office is in a third country. Over a period of approximately four years, the company had failed in a negligent manner to report more than 160,000 exchange transactions in accordance with section 9 (1) of the Securities Trading Act. Companies domiciled outside the European Union that are admitted to trading on a domestic stock exchange and trade on that exchange are subject to the reporting requirement to BaFin. The institution in question justified its failure to file the reports in the first year by, among other things, claiming that it had misinterpreted the relevant national securities law provisions. The company had, however, failed to realise that it has an obligation to familiarise itself with the relevant national requirements. If that is not possible, it can ensure compliance, for example by submitting a query to the supervisory authority.

Naked short selling

BaFin imposed administrative fines totalling €60,000 on a company for committing two negligent violations of the ban on short selling. The company had sold more than 200,000 shares in two transactions without, until the end of that day, being the owner of the shares sold or having an absolutely enforceable claim under contract or property law to be transferred ownership of the shares sold.

42 www.bafin.de/dok/7852642 (only available in German).

43 Article 29 of the Transparency Directive II, Directive 2013/50/EU, OJ EU L 294/13.

44 Article 34 of the MAR, Regulation (EU) No 596/2014, OJ EU L 173/1.

VI About BaFin

1 Human resources

As at 31 December 2016, BaFin had a total of 2,552 employees (previous year: 2,577) at its locations in Bonn (1,882) and Frankfurt am Main (670). Approximately 76.57 % (1,954) were civil servants (*Beamte*) and approximately 23.43 % (598) were public service employees covered by collective wage agreements (*Tarifbeschäftigte*) and others not covered by collective wage agreements (see Table 28, "Personnel").

74 BaFin employees were on long-term assignment to international institutions and supervisory authorities as at 31 December. At the close of 2016, approximately half that number, namely 36 employees, were delegated to the European Central Bank (ECB).

A total of 80 new staff recruited

In 2016, BaFin recruited a total of 80 new members of staff, 24 fewer than in 2015 (see Table 29 "Recruitment in 2016" on page 203).

Table 28 Personnel

As at 31 December 2016

Career level	Employees			of which civil servants	of which public service employees
	Total	Female	Male	Total	Total
Higher civil service	1,186	476	710	1,094	92*
Higher intermediate civil service	817	366	451	700	117
Intermediate/ basic civil service	549	370	179	160	389
Total	**2,552**	**1,212**	**1,340**	**1,954**	**598***

* Including those employees not covered by collective wage agreements.

Table 29 Recruitment in 2016

Career level	Total	Female	Male
Higher civil service	**54**	**21**	**33**
Qualifications			
Fully qualified lawyers	32		
Economists	11		
Mathematicians/statisticians	6		
Other	5		
Higher intermediate civil service	**5**	**4**	**1**
Qualifications			
Business lawyers	0		
Economists	1		
Career training	1		
Other	3		
Intermediate/ basic civil service	**21**	**16**	**5**
Total	**80**	**41**	**39**

The majority of the new recruits were fully qualified lawyers, but they also comprised economists, mathematicians and graduates in other disciplines from higher education institutions and universities of applied sciences. In addition, they included candidates for entry to the higher intermediate civil service and vocational trainees for the intermediate civil service.

Career entry at BaFin

Those starting their careers at BaFin may prepare for a position as an officer in the higher intermediate civil service by pursuing an integrated degree programme (*duales Studium*) in central banking. BaFin works together with the Deutsche Bundesbank for this purpose. The theoretical studies take place at the University of Applied Sciences in Hachenburg and the practical studies generally at BaFin. It is also possible to study information technology for public administration at the Federal University of Applied Administrative Sciences (*Hochschule des Bundes für öffentliche Verwaltung*).

Four candidates for entry to the higher intermediate civil service began preparing for their careers at BaFin in 2016, eleven fewer than in the previous year as there was a lower requirement. By the end of the year under review, BaFin was preparing a total of 26 candidates for entry to the higher intermediate civil service for their future 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.

Those starting their careers at BaFin may also complete vocational training for the intermediate civil service. BaFin currently provides vocational training in 4 different careers: administration specialists (21 vocational trainees), IT specialists for system integration (3 vocational trainees), business administration specialists for office management (6 vocational trainees) and media and information services specialists, specialising in librarianship (1 vocational trainee). 8 trainees began their vocational training in 2016 (previous year: 8). At the end of 2016, BaFin had a total of 57 vocational trainees and candidates for entry to the higher intermediate civil service, compared with 66 in the previous year.

Continuing professional development (CPD)

BaFin attaches great importance to an extensive CPD offering for its employees. In 2016, BaFin employees took part in a total of 673 CPD events (previous year: 709). The total number of attendances at such events was 4,037 (previous year: 4,601). On average, each BaFin employee attended a CPD session on 3.1 days in 2016 (previous year: 4.12 days).

The CPD courses during the past year were primarily focused on specialist supervisory topics. The introduction of Solvency II on 1 January 2016 was supported by CPD events in 2016 as well. In addition, BaFin was able to significantly expand its CPD sessions offered on the Single Supervisory Mechanism for banks (SSM) in collaboration with the European supervisory authorities and national banks as well as the European Central Bank.

In 2016, BaFin also provided new specialist English courses over several days in order to

enhance its employees' foreign language skills. Furthermore, employees had the opportunity to participate in a variety of courses on soft skills with the aim of developing cooperation between employees and the ability to work in a team.

BaFin as an employer

BaFin conducts regular selection processes at both its locations for fully qualified lawyers, economists and – mainly for insurance supervision in Bonn – mathematicians. Depending on its requirements, it also advertised vacancies for specialist divisions, for example for the IT and Language Services divisions.

BaFin is in competition with other German and international authorities and institutions as well as the private sector for the recruitment of qualified staff. As Germany's all-in-one financial supervisory authority, BaFin is able to score over other employers with its broad range of responsibilities. Both of BaFin's locations provide the opportunity for a varied and attractive career. This includes secondments at European level or worldwide and to the Federal Ministry of Finance (*Bundesministerium der Finanzen*).

Many applicants value the opportunity in principle to become a civil servant, while others – experts with many years of career experience in areas such as risk modelling and risk controlling – appreciate the remuneration in excess of collectively agreed levels. The financial markets allowance payable to all BaFin employees is a further attraction. Variable hours (flexitime), opportunities for teleworking and part-time work and in-house childcare facilities at both locations make it easier to combine a career with family life and appeal to male and female applicants alike.

For the purpose of selecting its staff, BaFin employs processes designed to match the particular career path. For the higher civil service, for example, it has established a multi-stage process consisting of an interview, an assessment center and an English test. The interview covers the specialist aspects of the process, and all applicants have to answer the same questions with the same background information to ensure that they are treated on an equal basis as far as possible.

BaFin is required to comply with the principle of selecting the best candidate in accordance with article 33 of the German Basic Law (*Grundgesetz*) when filling staff vacancies. This gives rise, among other things, to the obligation to advertise vacant positions publicly in order to reach a wide range of potentially interested applicants. BaFin is therefore only able to consider applications submitted for advertised vacancies.

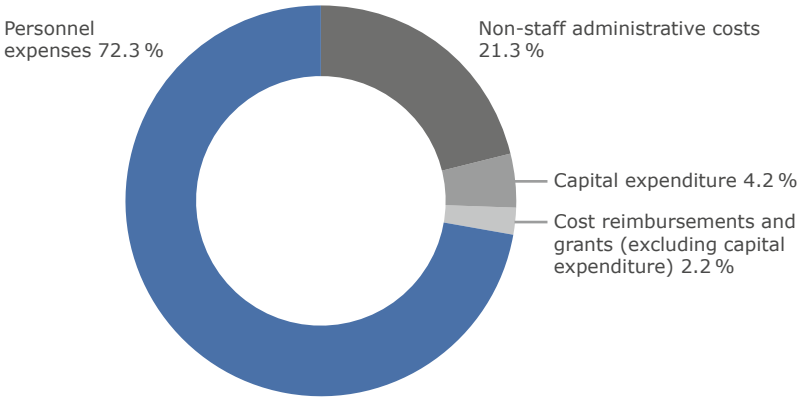
2 Budget

BaFin's Administrative Council approved a budget of €262.8 million for 2016 (previous year: €242.1 million). Personnel expenses accounted for around 72.3% of the projected expenditure (€189.9 million; previous year: €168.3 million) and non-staff costs for around 21.3% (€55.9 million; previous year: €60.6 million). Capital expenditure represented 4.2% of the budget (previous year: 3.3%). Cost reimbursements and grants were unchanged at 2.2% of the budget as in the previous year (see Figure 21 "2016 budget expenditure" on page 205).

Financing through cost allocations and fees

BaFin is independent of the federal budget and is fully self-financed from its own income. The largest proportion of this in the 2016 budget was attributable to cost allocations levied on the supervised undertakings, a special levy with a financing function (projected figure for 2016: €236.3 million; previous year: €220.6 million). BaFin also finances itself from administrative income such as fees and interest (projected figure for 2016: €26.5 million; previous year: €21.5 million; see Figure 22 "2016 budget income" on page 205).

Figure 21 2016 budget expenditure



The final cost allocation for 2015 was performed in 2016 (see Figure 23 "Cost allocations by supervisory area in 2015" on page 206). The banking industry contributed 46.9 % or almost half of the total income from cost allocations. The insurance sector financed 28.8 % and the securities trading sector 24.3 %. The final cost allocation for 2016 will take place during 2017.

Actual expenditure and income

BaFin's actual expenditure in 2016 was approximately € 248 million (previous year: € 237 million) and therefore € 14.8 million below the figure reported in the 2016 budget. This was set against income of around € 261.5 million (previous year: € 243.1 million). BaFin's Administrative Council had not yet approved the 2016 annual financial statements at the time of going to press.

Separate enforcement budget

BaFin drew up a separate enforcement budget of € 8.2 million in 2016 (previous year: € 8.2 million). This included an allocation to the German Financial Reporting Enforcement Panel (*Deutsche Prüfstelle für Rechnungslegung*) amounting to € 6 million (previous year: € 6 million). Actual expenditure on enforcement amounted to around € 7.8 million (previous year: € 7.7 million), while income – including advance cost allocation payments for 2017 – amounted in total to approximately € 14.7 million (previous year: € 14.7 million).

Figure 22 2016 budget income

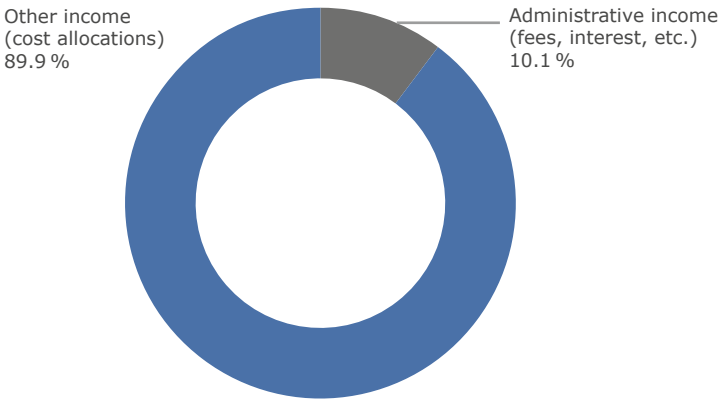
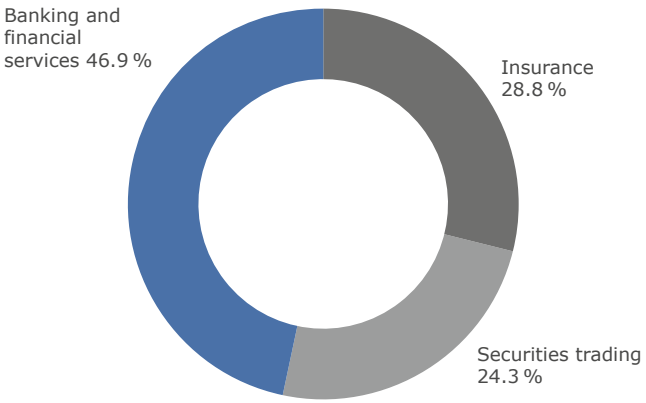


Figure 23 Cost allocations by supervisory area in 2015



3 Press and Public Relations

3.1 Press enquiries

In 2016, BaFin again received several thousand enquiries from journalists relating to its various areas of responsibility.

Fintech companies and Brexit

As in the previous year, there were many questions on fintech companies and their regulation. Matters of interest included what organisational arrangements BaFin has made to enable it to respond to the particular challenges posed by these companies.

In the wake of the referendum on the United Kingdom leaving the European Union ("Brexit"), BaFin received many enquiries on the consequences of Brexit for the British financial sector. Among other topics, journalists were interested to know under what circumstances British financial institutions would be permitted to conduct business with customers in other EU countries if they no longer had EU passporting rights. Other questions included whether any institutions had approached BaFin with a view to relocating to Germany yet and what supervisory requirements would apply to them in that event.

Basel and cum-ex transactions

The media also showed considerable interest in the investigations by BaFin's Banking Supervision Directorate into cum-ex transactions and the "Panama Papers". At the end of the year, the media focused increasingly on the negotiations being conducted by the Basel Committee on Banking Supervision (BCBS). The main topics of interest were the positions of the parties participating in the negotiations and the potential consequences for financial institutions.

Also at the end of the year, many journalists sought information on the revised version of the German Remuneration Ordinance for Institutions (*Institutsvergütungsverordnung*) since, among other things, it is expected to include mandatory provisions permitting variable components of remuneration already paid to be clawed back during a limited period of time.

Payment Accounts Act and whistleblowers

The provisions of the German Payment Accounts Act (*Zahlungskontengesetz*) relating to the basic payment account also generated a large number of press enquiries. Journalists sought information on the conditions under which an institution can decline to open an account and wanted to know whether any customers had yet lodged complaints.

The contact point for whistleblowers established by BaFin in 2016 also generated a significant

reaction in the media. The principal question was how BaFin protects whistleblowers. Journalists also wanted to know how many reports had been received from whistleblowers and whether BaFin had already taken any action in response.

Low interest rates

As before, the low interest-rate environment and its effects on the life insurance industry are a major topic for the media too. Questions in 2016 focused in particular on the steadily growing size of the additional interest provision (*Zinszusatzreserve* – ZRR), as well as on the exemptions (recalibration) BaFin has been offering undertakings in this connection since 2015. BaFin also regularly received enquiries relating to the situation facing the *Pensionskassen*. Another significant topic for the press was the stress test imposed by the European Insurance and Occupational Pensions Authority (EIOPA). The stress test applies to European insurers and essentially confirmed BaFin's own estimations.

Solvency II

For BaFin's Insurance Supervision Directorate, 2016 was also significantly affected by the introduction of the new Solvency II supervisory regime. BaFin presented the first figures, including those relating to individual insurance classes, in the summer, generating a wide response in the media. Portfolio transfers also attracted greater attention in the media during 2016, especially in the light of BaFin's approval for the transfer of the Basler Leben portfolio to Frankfurter Leben.

Press enquiries were also concerned with the communications sent by life insurers to their customers informing them how their entitlements have performed during the most recent year. Criticisms made by consumer protection bodies included the claim that the annual statements of account provided by some undertakings were difficult to understand. A further topic debated in the press related to the increases in premiums for private health insurance expected to apply from 1 January 2017.

Product intervention

The announcement of BaFin's first product intervention measures, in particular the ban on the sale of credit-linked notes, as they were known, to retail investors that BaFin was considering, generated great interest in the media. Equally, the German and international press paid close attention to the voluntary undertaking by the industry at the end of 2016. In mid-December BaFin announced that it was planning to impose restrictions on the marketing, distribution and sale of contracts for difference (CFDs) in order to protect retail investors. Its view was that the sale to retail investors of contracts entailing an obligation to make additional payments should no longer be permitted in order to protect them from losses. Comments on the draft general administrative act could be submitted in writing until 20 January 2017.

Merger of Deutsche Börse/London Stock Exchange

The media also attached great importance to the proposed merger of Deutsche Börse with the London Stock Exchange. Public interest focused on BaFin's investigations into ad hoc disclosures and insider trading, in addition to the status of the takeover proceedings under the German Securities Acquisition and Takeover Act (*Wertpapiererwerbs- und Übernahmegesetz*).

Preparations for MiFID II

The markets and the media were equally preoccupied in 2016 with the question of when the European Markets in Financial Instruments Directive (MiFID II) would come into force, and what provisions it would contain. The ministerial draft bill for the Second Financial Markets Amendment Act (*Zweites Finanzmarktnovellierungsgesetz*), which was published at the end of September 2016 and transposes the directive into German law, was eagerly awaited. Questions received by BaFin from representatives of the press related mainly to the parallel provision of commission-based and fee-based investment advice, but also to how banks would be required to record orders placed by customers in future.

3.2 Events and trade fairs

Forum on "White-collar Crime and the Capital Market"

On 15 and 16 November 2016, BaFin hosted its annual forum on "White-Collar Crime and the Capital Market" for the 13th time. The objective of the forum is assist in combating white-collar crime even more effectively. The principal topics under discussion this time were market manipulation, cybercriminality and unauthorised transactions by pawn shops. The participants consisted of 450 police officers, judges, public prosecutors as well as employees of the Deutsche Bundesbank, stock exchange supervisory authorities, trading surveillance offices of stock exchanges and foreign supervisory authorities. The participants also had the opportunity to attend seminars, such as those on the Market Abuse Regulation (*Marktmissbrauchsverordnung*) and on price determination on the stock exchanges.

Consumer protection forum

The central question addressed by BaFin's fourth consumer protection forum on 29 November 2016 was how to structure consumer protection in the financial industry so as to cover consumers as a whole and not just individual consumers. Representatives of ministries and consumer protection organisations, industry and German and European supervisory authorities discussed this issue in the German National Library in Frankfurt. The main topics were the implementation in practice of collective consumer protection, which is one of BaFin's responsibilities, fintech companies and product regulation.

"BaFin-Tech" conference on fintech companies

On 28 June 2016, BaFin hosted its "BaFin-Tech" conference on fintech companies for founders and representatives of undertakings in the financial sector. The 200 participants discussed current supervisory topics and business models in panel discussions together with representatives of the supervisory authorities, federal ministries and academia. Participants were also able to attend workshops on crowdfunding, alternative payment services, robo advice and blockchain technologies.

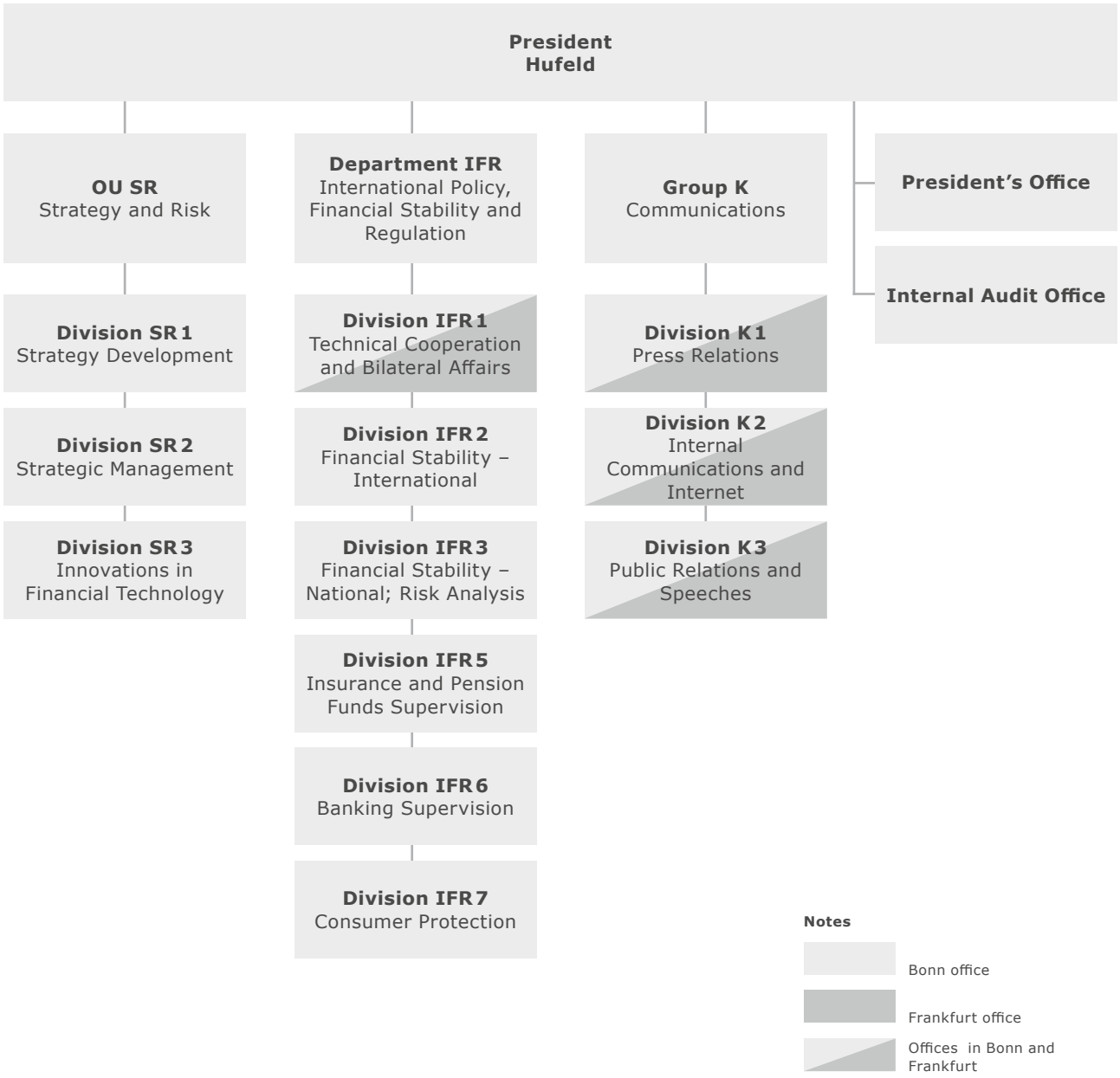
Information for investors

In April 2016, BaFin took part in the "Invest" trade fair in Stuttgart, providing information for investors. Talks given by BaFin representatives enabled investors to learn about market manipulation and discover whether retail derivative instruments are too risky for consumers, among other topics.

BaFin also gave members of the public the opportunity to put their questions in one-on-one discussions with its representatives at the *Börsentage* in Berlin, Dresden, Munich and Hamburg as well as at the Federal Ministry of Finance's open house in Berlin.

Appendix

1 Organisation chart*

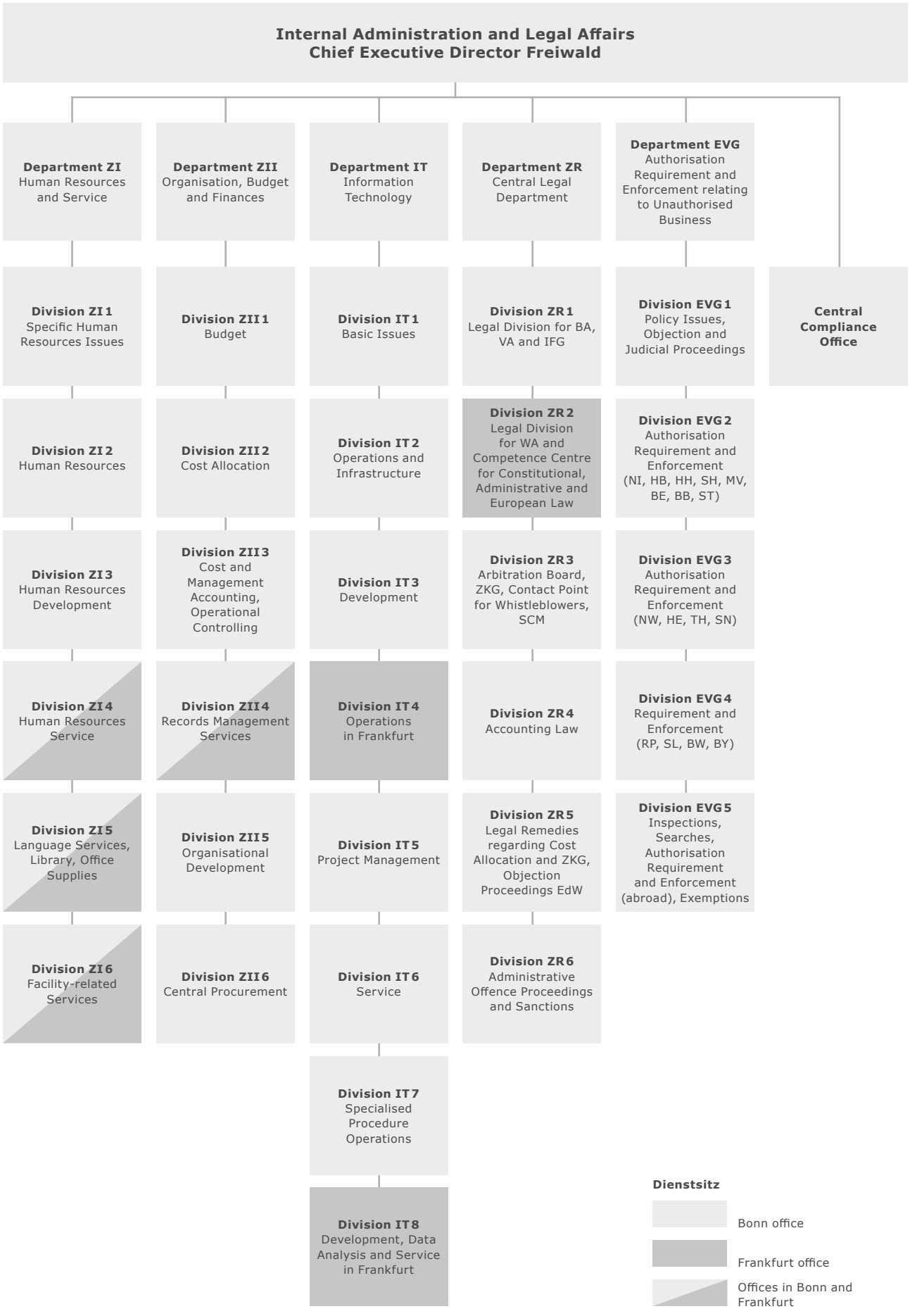


* As at: April 2017


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
DZ BANK AG Group
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, Development, Guarantee and Foreign Banks (if not SI)
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
Non-European and Swiss Banks
Division BA 46
KfW Group, Pro-Credit, Development Banks and Guarantee Banks
Division BA 47
European 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
Division BA 57
Pfandbrief Competence Centre/Examination of Cover Assets
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
Division GW 7
AML/CFT Supervision of Credit Institutions
Division GW 8
AML/CFT Supervision of Credit Institutions under Intensified Supervision
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


Insurance and Pension Funds Supervision
Chief Executive Director Grund
Department VA 1
Group Supervision, Institutions for Occupational Retirement Provision, Health Insurance
Division VA 11
Supervision of Groups (incl. Debeka and Continentale) and Individual Health Insurers
Division VA 12
Supervision of Pension Funds (incl. Bayer, BASF, Wacker and Novartis)
Division VA 13
Supervision of Pension Funds (incl. Allianz); Notification Procedure
Division VA 14
Supervision of Pension Funds (incl. R+V, ERGO and Generali)
Division VA 15
Competence Centre forActuarial Issues and Health Insurance Products; Basic Issues relating to Health Insurance and Medicator
Division VA 16
Supervision of Pension Funds (incl. BVV), PSV; Basic Issues relating to Occupational Retirement Provision
Department VA 2
Group Supervision, Life insurance, Funeral Expenses Funds, Investments
Division VA 21
Supervision of Groups (incl. Nürnberger and Zurich), Individual Life Insurers and Funeral Expenses Funds
Division VA 22
Supervision of Groups (incl. R+V and Alte Leipziger), Individual Life Insurers and Funeral Expenses Funds
Division VA 23
Basic Issues relating to ALM; Competence Centre for Risk Management and Use Test for Investments
Division VA 24
Competence Centre for Actuarial Issues; Life Insurance and Accident Insurance with Premium Refund
Division VA 25
Basic Issues relating to Investments
Division VA 26
Basic Issues relating to Life Insurance, Accident Insurance with Premium Refund (UPR) and Funeral Expenses Funds; Compe-tence Centre for Life Insurance and UPR Products; Supervision of Protektor and EU/EEA Service Providers and Branches
Department VA 3
Group Supervision, Property/Casualty Insurance, Special Topics
Division VA 31
Supervision of Groups and Individual Property/ Casualty Insurers (incl. ARAG)
Division VA 32
Supervision of Groups under Public Law and Individual Property/Casualty Insurers
Division VA 33
Supervision of Groups Headed by a Mutual Society (incl. HUKCoburg and Gothaer)
Division VA 34
Competence Centre for Investment Reporting and Guarantee Assets (Sicherungsvermögen)
Division VA 35
Competence Centre for Distribution Management and Remuneration Systems
Division VA 36
Competence Centre for Ad Hoc Inspections and Special Topics of Undertakings
Division VA 37
Basic Issues relating to Property/ Casualty Insurance; Supervision of Individual Insurers
Department VA 4
Supervision of International Groups, Internal Models, Reinsurance
Division VA 41
Supervision of Allianz Group
Division VA 42
Supervision of Munich Re and ERGO Group
Division VA 43
Supervision of HDI and Talanx Group
Division VA 44
Supervision of Groups with Parent Company Abroad (incl. AXA and Generali Group)
Division VA 45
Basic Issues relating to Qualitative Internal Model Assessment
Division VA 46
Basic Issues relating to Financial Conglomerates, Supervisory Colleges and G-SIIs; Supervision of W&W Group
Department VA 5
Cross-departmental Basic Issues, Supervision Management, Service
Division VA 51
Communication, Know-ledge Management, Freedom of Information Act (IFG); Interface with Budget; Event Service VA
Division VA 52
National Legislation relating to the Insurance Sector, Insurance Law
Division VA 53
IT Interface, Statistics, Register, Reporting (Technical Issues)
Division VA 54
Risk Management and Governance incl. ORSA (Qualitative)
Division VA 55
Supervisory Processes, Management of Supervision, Financial Stability and Analyses
Division VA 56
Solvency, Accounting, Provisioning, Reporting (Substantive Issues)
Department Q RM
Quantitative Risk Modelling (Cross-sectoral)
Division Q RM 1
Internal Models Credit Institutions: CCP, Counterparty Risk, Economic Capital
Division Q RM 2
Internal Models Credit Institutions: Market Risk
Division Q RM 3
Internal Models Credit Institutions: Credit Risk and Operational Risk
Division Q RM 4
Internal Models Insurers: Market Risk, Credit Risk, Underwriting Risk in Life and Private Health Insurance; Projection Model
Division Q RM 5
Internal Models Insurers: Underwriting Risk (Property/ Casualty Insurance) and Operational Risk; Aggregation


Securities Supervision / Asset Management
Chief Executive Director Roegele
Department WA 1
Policy Issues, Transparency, Administrative Offence Proceedings
Division WA 11
Legislative Process and Policy Issues WA
Division WA 12
Clearing Obligations for OTC Derivatives (EMIR)
Division WA 13
Voting Rights
Division WA 14
Reporting Requirements for Transactions in Financial Instruments
Division WA 15
Financial Reporting Enforcement and Transparency Requirements of Issuers
Division WA 16
Company Takeovers
Division WA 17
Administrative Offence Proceedings
Department WA 2
Market Surveillance, Market Infrastructure
Division WA 21
Policy Issues/ Secondary Markets
Division WA 22
Supervision of Financial Market Infrastructures
Division WA 23
Investigation of Market Manipulation
Division WA 24
Market Abuse Analysis
Division WA 25
Trading Suspension, Short-Selling Monitoring, Managers' Transactions
Division WA 26
Ad Hoc Disclosure
Division WA 27
Insider Surveillance
Department WA 3
Financial Services Institutions, Organisational Requirements
Division WA 31
Policy Issues relating to Supervision of Financial Services Institutions and Organisational Requirements
Division WA 32
Supervision of Financial Services Institutions I
Division WA 33
Supervision of Financial Services Institutions II
Division WA 34
Supervision of Financial Services Institutions III
Division WA 35
Supervision of Securities Trading Banks
Division WA 36
Organisational Requirements for Private Banks, Savings Banks, Cooperative Banks
Department WA 4
Investment Supervision
Division WA 41
Policy Issues
Division WA 42
Supervision of German Asset Management Companies, Investment Funds, Depositaries I
Division WA 43
Supervision of German Asset Management Companies, Investment Funds, Depositaries II
Division WA 44
Supervision of German Asset Management Companies, Investment Funds, Depositaries III
Division WA 45
Supervision of German Asset Management Companies, Investment Funds, Depositaries IV
Division WA 46
Supervision of German Asset Management Companies, Investment Funds, Depositaries V
Division WA 47
Supervision of German Asset Management Companies, Investment Funds, Depositaries VI
Department WA 5
Prospectuses, Supervision of Research Analysts
Division WA 51
Policy Issues
Division WA 52
Securities prospectuses for public offers without admission to trading on the organised market/ Base prospectuses (A-G)
Division WA 53
Securities prospectuses for admission to trading on the organised market/Base prospectuses (H-Z)
Division WA 54
Approval of Non-Securities Investment Prospectuses
Division WA 55
Supervision of Non-Securities Investment Products and Offers of Securities
Division WA 56
Supervision of Ratings Users and Persons who Produce or Disseminate Investment Research
Department VBS
Consumer Protection
Division VBS 1
Policy Issues, Consumer Protection Forum and Consumer Advisory Council
Division VBS 2
Consumer Trend Analysis and Consumer Education
Division VBS 3
Competence Centre for Consumer Protection relating to Banks, Complaints
Division VBS 4
Competence Centre for Consumer Protection relating to Insurance, Complaints
Division VBS 5
Supervision of Compliance with Rules of Conduct, Investor Protection Private & Foreign Banks
Division VBS 6
Supervision of Compliance with Rules of Conduct, Investor Protection Savings Banks & Cooperative Banks
Division VBS 7
Supervision of Violations of Consumer Protection Law, Product Intervention


Internal Administration and Legal Affairs
Chief Executive Director Freiwald
Department ZI
Human Resources and Service
Department ZII
Organisation, Budget and Finances
Department IT
Information Technology
Department ZR
Central Legal Department
Department EVG
Authorisation Requirement and Enforcement relating to Unauthorised Business
Division ZI1
Specific Human Resources Issues
Division ZII1
Budget
Division IT1
Basic Issues
Division ZR1
Legal Division for BA, VA and IFG
Division EVG1
Policy Issues, Objection and Judicial Proceedings
Central Compliance Office
Division ZI2
Human Resources
Division ZII2
Cost Allocation
Division IT2
Operations and Infrastructure
Division ZR2
Legal Division for WA and Competence Centre for Constitutional, Administrative and European Law
Division EVG2
Authorisation Requirement and Enforcement (NI, HB, HH, SH, MV, BE, BB, ST)
Division ZI3
Human Resources Development
Division ZII3
Cost and Management Accounting, Operational Controlling
Division IT3
Development
Division ZR3
Arbitration Board, ZKG, Contact Point for Whistleblowers, SCM
Division EVG3
Authorisation Requirement and Enforcement (NW, HE, TH, SN)
Division ZI4
Human Resources Service
Division ZII4
Records Management Services
Division IT4
Operations in Frankfurt
Division ZR4
Accounting Law
Division EVG4
Requirement and Enforcement (RP, SL, BW, BY)
Division ZI5
Language Services, Library, Office Supplies
Division ZII5
Organisational Development
Division IT5
Project Management
Division ZR5
Legal Remedies regarding Cost Allocation and ZKG, Objection Proceedings EdW
Division EVG5
Inspections, Searches, Authorisation Requirement and Enforcement (abroad), Exemptions
Division ZI6
Facility-related Services
Division ZII6
Central Procurement
Division IT6
Service
Division ZR6
Administrative Offence Proceedings and Sanctions
Division IT7
Specialised Procedure Operations
Division IT8
Development, Data Analysis and Service in Frankfurt
Dienstsitz
Bonn office
Frankfurt office
Offices in Bonn and Frankfurt

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Reinhard Wolpers (BMF)
Dr Raphael L'Hoest (BMWi)
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Helga Springeneer (BMJV)

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 2017

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Dr Markus Faulhaber

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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 (Chair)

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

Ralf Brunkow

As at: March 2017

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Dr Karin Becker

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Norbert Heinen

Burkhard Keese

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Hubertus Münster

Prof. Petra Pohlmann

Dr Markus Rieß

Holger R. Rohde

Prof. Heinrich R. Schradin

Ilona Stumm

Prof. Manfred Wandt

Michael Wortberg

As at: April 2017

2.4 Members of the Securities Council

Baden-Württemberg State Ministry for Finance and Economics

Bavarian Ministry of Economic Affairs and Media, Energy 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, Labour, Energy and Transport 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 2017

2.5 Members of the Consumer Advisory Council

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Prof. Kai-Oliver Knops
Prof. Udo Reifner

Representing consumer and investor protection organisations

Jella Benner-Heinacher
Stephan Kühnlenz
Dorothea Mohn (Chair)
Katharina Lawrence

Representing out-of-court dispute settlement systems

Wolfgang Arenhövel
Dr Peter Frellesen
Prof. Günter Hirsch

Representing the Federal Ministry of Justice and Consumer Protection

Dr Erich Paetz

Representing the trade unions

Christoph Hahn

As at: March 2017

3 Authorised credit institutions, insurers and *Pensionsfonds*

3.1 Credit institutions supervised by BaFin or the ECB

3.1.1 Authorised institutions

In 2016 BaFin was responsible for supervising a total of 1,655 German credit institutions (previous year: 1,724) and 47 housing enterprises with savings schemes (previous year: 47, see Table 30).

Table 30 German institutions

CRR credit institutions		1596
	of which SIs*	66
	of which LSIs	1530
Securities trading banks		26
Other credit institutions		33
Total credit institutions		**1655****
Housing enterprises with savings schemes		**47**

* The SIs are supervised directly by the ECB.
** Two of these credit institutions provide financial market infrastructures and are therefore supervised by BaFin's Securities Supervision Directorate.

Of the total of 1,655 credit institutions, 1,596 were CRR credit institutions (previous year: 1,665). Of these 1,596 CRR credit institutions, 1,530 (previous year: 1,598) were subject to direct supervision by BaFin as less significant institutions (LSIs) under the Single Supervisory Mechanism (SSM) (see info box "Definitions"). The 26 securities trading banks, 33 other credit institutions and 47 housing enterprises with savings schemes referred to in Table 30 were supervised exclusively by BaFin.

3.1.2 German institutions directly supervised by the ECB under the SSM

66 of the German CRR credit institutions referred to in Table 30 (previous year: 67) were directly supervised by the European Central Bank (ECB) in 2016 as significant institutions (SIs) under the SSM. BaFin was and is involved in their supervision as part of the SSM.

Definitions

A **credit institution** is an undertaking which conducts at least one of the banking businesses described in detail in section 1 (1) of the German Banking Act (*Kreditwesengesetz*) 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.

Pursuant to section 1 (3d) of the Banking Act, a **CRR credit institution** is a credit institution that also meets the narrower definition of a credit institution in accordance with Article 4 (1) no. 1 of the EU Capital Requirements Regulation (CRR). CRR credit institutions are supervised in the context of the Single Supervisory Mechanism (SSM) either directly by the ECB as significant institutions (SIs) or by BaFin together with the Deutsche Bundesbank as less significant institutions (LSIs).

While the **securities trading banks** and the other credit institutions are not CRR institutions, they nevertheless fall within the German definition of a credit institution.

In accordance with section 1 (29) of the Banking Act, **housing enterprises with savings** schemes are undertakings with the legal form of a registered cooperative society, whose business object is principally the management of their own housing portfolios and which also conduct banking business solely in the form of deposit business, in a manner restricted by law. They have not been included in the credit institutions in this table.

Table 31 German institutions supervised by the ECB under the SSM

Aareal Bank AG
Bankhaus Neelmeyer Aktiengesellschaft
Bausparkasse Schwäbisch Hall Aktiengesellschaft, Bausparkasse der Volksbanken und Raiffeisenbanken
Bayerische Landesbank
Berlin Hyp AG
Bethmann Bank AG
BHW Bausparkasse Aktiengesellschaft
Bremer Landesbank Kreditanstalt Oldenburg -Girozentrale-
CACEIS Bank Deutschland GmbH
comdirect bank Aktiengesellschaft
Commerz Finanz GmbH
COMMERZBANK Aktiengesellschaft
CreditPlus Bank Aktiengesellschaft
DB Investment Services GmbH
DekaBank Deutsche Girozentrale
DEUTSCHE APOTHEKER- UND ÄRZTEBANK EG
DEUTSCHE BANK AKTIENGESELLSCHAFT
Deutsche Bank Bauspar-Aktiengesellschaft
Deutsche Bank Europe GmbH
Deutsche Bank Privat- und Geschäftskunden Aktiengesellschaft
Deutsche Genossenschafts-Hypothekenbank Aktiengesellschaft
Deutsche Hypothekenbank (Actien-Gesellschaft)
Deutsche Kreditbank Aktiengesellschaft
Deutsche Pfandbriefbank AG
Deutsche Postbank AG
Dexia Kommunalbank Deutschland AG
DVB Bank SE
DZ BANK AG Deutsche Zentral-Genossenschaftsbank, Frankfurt am Main
European Bank for Financial Services GmbH (ebase)
Frankfurter Bankgesellschaft (Deutschland) AG
Frankfurter Sparkasse
GEFA BANK GmbH
Hamburger Sparkasse AG
Hanseatic Bank GmbH & Co KG
HSH Nordbank AG
ING-DiBa AG
Landesbank Baden-Württemberg
Landesbank Berlin AG
Landesbank Hessen-Thüringen Girozentrale
Landeskreditbank Baden-Württemberg - Förderbank -
Landwirtschaftliche Rentenbank
Merck Finck Privatbankiers AG
MKB Mittelrheinische Bank Gesellschaft mit beschränkter Haftung
Münchener Hypothekenbank eG
NATIXIS Pfandbriefbank AG
Norddeutsche Landesbank -Girozentrale-
norisbank GmbH
NRW.BANK
OnVista Bank GmbH
PSA Bank Deutschland GmbH
S Broker AG & Co. KG
Sal. Oppenheim jr. & Cie. AG & Co. Kommanditgesellschaft auf Aktien
Santander Consumer Bank Aktiengesellschaft
SEB AG
Sparkasse Mittelholstein Aktiengesellschaft
State Street Bank International GmbH
TARGO Commercial Finance AG
TARGOBANK AG & Co. KGaA
TeamBank AG Nürnberg
UniCredit Bank AG
Volkswagen Bank Gesellschaft mit beschränkter Haftung
VON ESSEN Bank GmbH
VR DISKONTBANK GmbH
VTB Bank (Deutschland) Aktiengesellschaft
Westdeutsche ImmobilienBank AG
WL BANK AG Westfälische Landschaft Bodenkreditbank

3.1.3 Calculation of the capital requirements

Use of IRB approaches

As at the 31 December 2016 reporting date, a total of twelve LSIs were using internal ratings-based (IRB) approaches for the purpose of calculating their capital requirements for credit risk. In contrast, none of these institutions and groups of institutions applied the internal assessment approach (IAA) for securitisation positions.

The IRB approach makes a distinction between whether, beyond its retail business, an institution estimates only the probability of default (foundation IRB approach) itself or whether it also estimates the loss given default and the conversion factor (advanced IRB approach). A total of four of the twelve institutions and groups of institutions referred to above used the advanced IRB approach on a group or individual basis, and three institutions applied the IRB approach on an individual basis exclusively for the risk positions arising from their retail business.

Operational risk approaches

The institutions or groups of institutions in Germany employed all four available approaches to calculate their capital requirements for operational risk during the year under review. The basic indicator approach (BIA) and the standardised approach (STA) are determined using the specified indicator, which is based on the statement of profit and loss figures. At the 2016 year-end, just under 1,600 institutions and groups of institutions – almost exclusively LSIs – were using the basic indicator approach. Another 54 institutions or groups of institutions, of which 26 were supervised by the ECB as SIs and 28 by BaFin as LSIs, were applying the standardised approach. Two LSIs were working with the alternative standardised approach (ASA), which uses a standardised earnings indicator instead of the specified indicator.

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 requirement for the operational risk of an institution or group of institutions is calculated on the basis of this information with the help of a complex model. At the close of 2016, a total of 14 institutions and groups of institutions, of which three were LSIs, 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 is a cooperative bank and one is in the group of "Other institutions".

As in previous years, BaFin focused on the institutions' procedures for measuring, controlling and monitoring legal and IT risks in 2016.

3.2 Insurance undertakings and Pensionsfonds under BaFin's supervision

3.2.1 Authorised insurers and *Pensionsfonds*

The number of insurance undertakings supervised by BaFin declined slightly in 2016. At the end of the year under review, BaFin supervised a total of 555 insurance undertakings (previous year: 567) and 29 *Pensionsfonds*. Out of the total number of insurance undertakings, 534 were engaged in business activities and 21 were not. In order to give as full a picture as possible of the insurance market in Germany, all of the information in this chapter also includes eleven public-law insurance undertakings supervised by the federal states – ten conducting business activities and one without business activities. The analysis of the undertakings by insurance class is therefore as follows (see Table 32 on page 223):

Table 32 Number of supervised insurance undertakings and *Pensionsfonds**

As at 31 December 2016

	Insurance undertakings with business activities			Insurance undertakings without business activities		
	BaFin supervision	Federal states supervision	Total	BaFin supervision	Federal states supervision	Total
Life insurers	84	3	87	9	0	9
Pensionskasse	139	0	139	2	0	2
Funeral expenses funds	35	0	35	1	0	1
Health insurers	46	0	46	0	0	0
Property/casualty insurers**	201	7	208	5	1	6
Reinsurers	29	0	29	4	0	4
Total	**534**	**10**	**544**	**21**	**1**	**22**
Pensionsfonds	29	0	29	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 2015 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 2.4.2.

Life insurers

One German life insurer supervised by BaFin ceased operating in 2016. One undertaking was newly authorised.

One branch of an undertaking from Luxembourg ceased operating. Five insurers from the European Economic Area (EEA) registered for the cross-border provision of services in Germany (see Table 33 "Registrations by EEA life insurers in 2016").

Health insurers

Two health insurance undertakings ceased operating. One undertaking was newly authorised.

Property and casualty insurers

Ten property and casualty insurers supervised by BaFin ceased operating in 2016. Three undertakings were newly authorised during the year under review. Five property and casualty insurers from the EEA (Finland, Luxembourg, Spain and two from the United Kingdom) established a branch office in Germany. Two branch offices from the United Kingdom and two from the Netherlands ceased operating. 27 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 (see Table 34 "Registrations by EEA property and casualty insurers in 2016" on page 224).

Reinsurers

The number of active reinsurers under BaFin's supervision increased to 29 in the year under review. Four reinsurers are no longer accepting new business. Six branches of undertakings from the EEA (Ireland, Spain, Luxembourg and three from France) were operating in Germany in 2016.

Table 33 Registrations by EEA life insurers in 2016

As at 31 December 2016

Country	CBS*	BO**
Denmark	1	
Hungary	1	
Luxembourg	1	
Netherlands	1	
United Kingdom	1	

* CBS = Cross-border provision of services within the meaning of section 61 (3) of the Insurance Supervision Act (*Versicherungsaufsichtsgesetz*).
** BO = Branch office business within the meaning of section 61 (2) of the Insurance Supervision Act.

Table 34 Registrations by EEA property and casualty insurers in 2016

Country	CBS*	BO**
Bulgaria	1	
Denmark	2	
Finland		1
France	2	
United Kingdom	4	2
Ireland	2	
Liechtenstein	1	
Lithuania	1	
Luxembourg	1	1
Malta	2	
Netherlands	5	
Poland	1	
Slovenia	2	
Spain	2	1
Cyprus	1	

* CBS = Cross-border provision of services within the meaning of section 61 (3) of the Insurance Supervision Act.
** BO = Branch office business within the meaning of section 61 (2) of the Insurance Supervision Act.

Pensionskassen, *Pensionsfonds* and funeral expenses funds

Three *Pensionskassen*, two *Pensionsfonds* and one funeral expenses fund ceased operating in 2016.

3.2.2 Approval procedures under Solvency II

Insurance undertakings are required to calculate their solvency capital requirement (SCR) at least once a year. This involves applying the standard formula in principle, but variations are permitted with the approval of BaFin (section 109 of the Insurance Supervision Act). Alternatively, the undertakings may calculate their SCR using an internal model approved by the Supervisory Authority (section 111 of the Insurance Supervision Act).

Under Solvency II insurance undertakings have to prepare a solvency statement in which technical provisions must be recognised for all insurance obligations. At the request of the undertakings, BaFin may approve the use of volatility adjustments (section 82 of the Insurance Supervision Act) as well as transitional measures for risk-free interest rates (section 351 of the Insurance Supervision Act) and technical provisions (section 352 of the Insurance Supervision Act).

Table 35 below ("Approval procedures") gives an overview of the approvals granted up to the end of 2016:

Table 35 Approval procedures

As at 31 December 2016

Approval for the use of	
Undertaking-specific parameters	9
Group-specific parameters	2
Internal models (solo level)	36
– of which undertakings where BaFin is not the group supervisor	16
Internal models (group level)	7
– of which groups where BaFin is not the group supervisor	2
Volatility adjustment	83
Transitional measures (technical provisions and risk-free interest rates)	66

4 Complaints statistics for individual undertakings

4.1 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 2016 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 2016 is compared with the number of policies in the respective insurance class as at 31 December 2015. The individual undertakings report their existing business data. The information on existing business puts those insurers that recorded strong growth in the reporting period, often newly established undertakings, at a disadvantage because the new business written in the course of the year giving rise to the complaints is not adequately accounted for in the complaints statistics.

In the life insurance class, the existing business figure specified for group insurance relates to the number of insurance contracts. Existing health insurance business is based on the number of natural persons with health insurance contracts, rather than the number of insured persons under each premium scale, which is usually higher. As in the past, these figures are not yet entirely reliable.

The information on property and casualty insurance figures relates to insured risks. The existing business figure increases if undertakings agree group policies with large numbers of insured persons. Due to the limited disclosure requirements (section 51 (4) no. 1 sentence 4 of the Regulation on German Insurance Accounting (*Verordnung über die Rechnungslegung von Versicherungsunternehmen*), only the existing business figures for insurers whose gross premiums earned in 2015 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.

4.2 Life insurance

Reg. no.	Name of insurance undertaking	Number of insured risks as at 31 Dec. 2015	Complaints
1001	AACHENMüNCHENER LEB.	5,158,605	55
1006	ALLIANZ LEBEN	10,480,858	114
1007	ALTE LEIPZIGER LEBEN	1,325,565	9
1035	ARAG LEBEN	321,901	8
1017	ATHENE LEBEN AG	316,136	18
1020	AXA LEBEN	2,922,161	72
1011	BARMENIA LEBEN	239,468	2
1028	BASLER LEBEN	700,178	13
1012	BASLER LEBEN (CH)	112,869	1
1013	BAYER. BEAMTEN LEBEN	210,886	4
1015	BAYERN-VERS.	1,821,883	16
1122	CONCORDIA LEBEN	n.a.	1
1177	CONCORDIA OECO LEBEN	174,809	9
1021	CONDOR LEBEN	220,766	1
1335	CONTINENTALE LV AG	694,405	10
1022	COSMOS LEBEN	1,422,708	21
1115	CREDIT LIFE AG	1,157,682	2
1023	DEBEKA LEBEN	3,430,162	24
1167	DELTA DIREKT LEBEN	81,115	1
1136	DEVK ALLG. LEBEN	809,087	11
1025	DEVK DT. EISENBAHN LV	598,223	1
1113	DIALOG LEBEN	292,716	3
1110	DIREKTE LEBEN	121,145	2
1180	DT. ÄRZTEVERSICHERUNG	213,046	3
1148	DT. LEBENSVERS.	619,875	4
1130	ERGO DIREKT LEBEN AG	1,061,474	16
1184	ERGO LEBEN AG	4,847,983	89
1107	EUROPA LEBEN	476,953	9
1310	FAMILIENFüRSORGE LV	244,055	5
1139	GENERALI LEBEN AG	4,434,177	73
1108	GOTHAER LEBEN AG	1,351,538	36
1312	HANNOVERSCHE LV AG	958,316	9
1114	HANSEMERKUR LEBEN	293,707	7
1033	HDI LEBEN AG	2,307,115	64
1158	HEIDELBERGER LV	393,461	21
1137	HELVETIA LEBEN	149,000	2
1055	HUK-COBURG LEBEN	683,290	20
1047	IDEAL LEBEN	587,089	4
1048	IDUNA VEREINIGTE LV	1,743,217	23
1128	ITZEHOER LEBEN	71,098	1
1045	KARLSRUHER LV AG	91,800	3
1062	LEBENSVERS. VON 1871	672,471	10
1112	LVM LEBEN	792,294	5
1109	MECKLENBURG. LEBEN	163,810	3
1064	MÜNCHEN. VEREIN LEBEN	134,316	1
1342	MÜNCHENER VEREIN AG	n.a.	1
1134	NEUE BAYER. BEAMTEN	120,137	4
1164	NEUE LEBEN LEBENSVERS	914,706	13
1147	NÜRNBG. LEBEN	2,752,283	60
1194	PB LEBENSVERSICHERUNG	1,122,938	18
1123	PLUS LEBEN	72,095	4
1309	PROTEKTOR LV AG	107,844	6
1081	PROV. LEBEN HANNOVER	820,422	8

! Please refer to the “Explanatory notes on the statistics” on page 225.

Reg. no.	Name of insurance undertaking	Number of insured risks as at 31 Dec. 2015	Complaints
1083	PROV.NORDWEST LEBEN	1,701,356	14
1082	PROV.RHEINLAND LEBEN	1,262,798	23
1141	R+V LEBENSVERS. AG	4,240,885	36
1018	RHEINLAND LEBEN	95,286	1
1157	SKANDIA LEBEN	285,337	12
1153	SPARK.-VERS.SACHS.LEB	542,250	2
1104	STUTTGARTER LEBEN	484,054	17
1091	SV SPARKASSENVERS.	1,669,139	20
1090	SWISS LIFE AG (CH)	868,532	22
1132	TARGO LEBEN AG	1,769,295	11
1092	UNIVERSA LEBEN	181,178	5
1140	VICTORIA LEBEN	1,113,675	39
1099	VOLKSWOHL-BUND LEBEN	1,414,713	16
1151	VORSORGE LEBEN	165,585	8
1160	VPV LEBEN	794,388	6
1005	WÜRTT. LEBEN	2,206,302	19
1103	WWK LEBEN	912,096	21
1138	ZURICH DTSCH. HEROLD	3,359,974	68

! Please refer to the “Explanatory notes on the statistics” on page 225.

4.3 Health insurance

Reg. no.	Name of insurance undertaking	Number of persons insured as at 31, Dec, 2015	Complaints
4034	ALLIANZ PRIV.KV AG	2,588,833	66
4142	ALTE OLDENBURGER AG	162,302	5
4112	ARAG KRANKEN	573,493	11
4095	AXA KRANKEN	1,684,745	174
4042	BARMENIA KRANKEN	1,228,071	18
4134	BAYERISCHE BEAMTEN K	1,116,641	22
4004	CENTRAL KRANKEN	1,733,869	78
4001	CONTINENTALE KRANKEN	1,284,562	49
4028	DEBEKA KRANKEN	3,919,489	54
4131	DEVK KRANKENVERS.-AG	374,136	2
4044	DKV AG	4,396,653	167
4013	DT. RING KRANKEN	611,264	12
4121	ENVIVAS KRANKEN	403,607	7
4126	ERGO DIREKT KRANKEN	1,471,113	9
4119	GOTHAER KV AG	587,869	28
4043	HALLESCHE KRANKEN	655,204	33
4144	HANSEMERKUR KRANKEN_V	1,451,692	33
4117	HUK-COBURG KRANKEN	1,013,220	38
4031	INTER KRANKEN	375,673	18
4011	LANDESKRANKENHILFE	372,399	30
4109	LVM KRANKEN	342,680	6
4123	MANNHEIMER KRANKEN	75,852	6
4037	MÜNCHEN.VEREIN KV	295,737	13
4125	NÜRNBG. KRANKEN	264,875	2
4116	R+V KRANKEN	821,119	5
4002	SIGNAL KRANKEN	1,970,153	43
4039	SÜDDEUTSCHE KRANKEN	665,907	11
4108	UNION KRANKENVERS.	1,181,169	18
4045	UNIVERSA KRANKEN	357,379	10
4139	WÜRTT. KRANKEN	348,924	1

! Please refer to the “Explanatory notes on the statistics” on page 225.

4.4 Motor vehicle insurance

Reg. no.	Name of insurance undertaking	Number of persons insured as at 31, Dec, 2015	Complaints
5342	AACHENMÜNCHENER VERS.	2,356,173	13
5135	ADAC AUTOVERSICHERUNG	1,106,266	27
5312	ALLIANZ VERS.	12,542,939	83
5441	ALLSECUR DEUTSCHLAND	1,150,697	52
5405	ALTE LEIPZIGER VERS.	361,274	3
5455	ARAG ALLG. VERS.	n.a.	2
5397	ASSTEL SACH	155,017	3
5155	AXA EASY	n.a.	5
5515	AXA VERS.	4,335,385	68
5317	BARMENIA ALLG. VERS.	261,125	5
5633	BASLER SACH AG	318,431	6
5310	BAYER. BEAMTEN VERS.	193,091	1
5324	BAYER.VERS.VERB.AG	1,763,631	12
5146	BGV-VERSICHERUNG AG	506,309	2
5098	BRUDERHILFE SACH.AG	413,636	2
5338	CONCORDIA VERS.	1,008,449	5
5339	CONDOR ALLG. VERS.	246,118	3
5340	CONTINENTALE SACHVERS	707,128	9
5552	COSMOS VERS.	853,513	13
5343	DA DEUTSCHE ALLG.VER.	1,329,020	35
5311	DBV DT. BEAMTEN-VERS.	748,060	5
5549	DEBEKA ALLGEMEINE	856,101	1
5513	DEVK ALLG. VERS.	3,931,165	22
5344	DEVK DT. EISENB. SACH	1,008,550	1
5055	DIRECT LINE	1,192,379	34
5562	ERGO DIREKT	n.a.	6
5472	ERGO VERSICHERUNG	2,362,378	18
5508	EUROPA VERSICHERUNG	640,918	15
5470	FAHRLEHRERVERS.	323,524	2
5024	FEUERSOZIETÄT	140,948	2
5505	GARANTA VERS.	583,809	4
5473	GENERALI VERSICHERUNG	2,338,010	20
5858	GOTHAER ALLGEMEINE AG	1,411,664	5
5585	GVV-PRIVATVERSICH.	204,814	2
5131	HANNOVERSCHE DIREKT	n.a.	6
5501	HANSEMERKUR ALLG.	n.a.	1
5096	HDI GLOBAL SE	967,937	8
5085	HDI VERSICHERUNG	2,846,171	56
5384	HELVETIA VERS. (CH)	308,163	3
5086	HUK24 AG	3,264,202	37
5375	HUK-COBURG UNTER.	7,157,254	49
5521	HUK-COBURG-ALLG. VERS	8,247,585	49
5401	ITZEHOER VERSICHERUNG	1,357,148	19
5078	JANITOS VERSICHERUNG	143,794	5
5058	KRAVAG-ALLGEMEINE	1,542,074	26
5080	KRAVAG-LOGISTIC	1,027,026	20
5402	LVM SACH	5,695,420	22
5061	MANNHEIMER VERS.	209,541	2
5412	MECKLENBURG. VERS.	852,783	7
5426	NÜRNBG. ALLG.	225,267	7
5787	OVAG - OSTDT. VERS.	295,389	17
5446	PROV.NORD BRANDKASSE	776,125	3
5095	PROV.RHEINLAND VERS.	1,441,219	7

! Please refer to the “Explanatory notes on the statistics” on page 225.

Reg. no.	Name of insurance undertaking	Number of persons insured as at 31, Dec, 2015	Complaints
5438	R+V ALLGEMEINE VERS.	4,050,495	33
5137	R+V DIREKTVERSICHER.	435,170	21
5798	RHEINLAND VERS. AG	243,747	1
5051	S DIREKTVERSICHERUNG	297,089	6
5773	SAARLAND FEUERVERS.	164,997	1
5125	SIGNAL IDUNA ALLG.	1,076,530	4
5781	SPARK.-VERS.SACHS.ALL	177,364	1
5036	SV SPARK.VERSICHER.	988,729	7
5042	VERSICHERUNGSK.BAYERN	162,845	1
5400	VGH LAND.BRAND.HAN.	2,009,914	10
5862	VHV ALLGEMEINE VERS.	4,456,018	60
5169	VOLKSWAGEN AUTO AG	681,112	20
5484	VOLKSWOHL-BUND SACH	92,416	1
5093	WESTF.PROV.VERS.AG	1,444,414	3
5525	WGV-VERSICHERUNG	1,227,706	11
5479	WÜRTT. GEMEINDE-VERS.	1,025,935	3
5783	WÜRTT. VERS.	2,855,529	28

! Please refer to the “Explanatory notes on the statistics” on page 225.

4.5 General liability insurance

Reg. no.	Name of insurance undertaking	Number of insured risks as at 31 Dec. 2015	Complaints
5342	AACHENMÜNCHENER VERS.	1,290,223	9
5312	ALLIANZ VERS.	4,313,582	41
5405	ALTE LEIPZIGER VERS.	203,896	1
5455	ARAG ALLG. VERS.	21,026,463	4
5397	ASSTEL SACH	245,426	6
5515	AXA VERS.	2,694,649	25
5316	BAD. GEMEINDE-VERS.	2,896	1
5792	BADEN-BADENER VERS.	n.a.	1
5317	BARMENIA ALLG. VERS.	202,365	1
5633	BASLER SACH AG	333,583	4
5310	BAYER. BEAMTEN VERS.	n.a.	1
5324	BAYER.VERS.VERB.AG	1,109,566	11
5098	BRUDERHILFE SACH.AG	215,260	1
5340	CONTINENTALE SACHVERS	424,679	6
5552	COSMOS VERS.	310,403	1
5311	DBV DT. BEAMTEN-VERS.	605,774	4
5513	DEVK ALLG. VERS.	1,192,916	8
5129	DFV DEUTSCHE FAM.VERS	n.a.	1
5472	ERGO VERSICHERUNG	1,629,355	36
5024	FEUERSOZIETÄT	162,381	2
5473	GENERALI VERSICHERUNG	1,611,583	12
5858	GOTHAER ALLGEMEINE AG	1,371,862	7
5485	GRUNDEIGENTÜMER-VERS.	n.a.	1
5469	GVV-KOMMUNALVERS.	3,114	2
5374	HAFTPFLICHTK.DARMST.	1,265,882	8
5501	HANSEMERKUR ALLG.	213,206	2
5096	HDI GLOBAL SE	15,760	4
5085	HDI VERSICHERUNG	1,396,833	32
5448	HELVETIA	n.a.	1
5384	HELVETIA VERS. (CH)	358,313	1
5086	HUK24 AG	421,806	5
5375	HUK-COBURG UNTER.	2,003,832	5
5521	HUK-COBURG-ALLG. VERS	1,515,273	9
5573	IDEAL VERS.	n.a.	3
5401	ITZEHOER VERSICHERUNG	167,533	1
5078	JANITOS VERSICHERUNG	201,634	5
5058	KRAVAG-ALLGEMEINE	n.a.	2
5402	LVM SACH	1,321,778	7
5412	MECKLENBURG. VERS.	278,812	4
5426	NÜRNBG. ALLG.	323,254	3
5015	NV-VERSICHERUNGEN	n.a.	1
5017	OSTANGLER BRANDGILDE	n.a.	1
5787	OVAG - OSTDT. VERS.	n.a.	6
5446	PROV.NORD BRANDKASSE	371,829	1
5095	PROV.RHEINLAND VERS.	836,261	5
5438	R+V ALLGEMEINE VERS.	1,835,284	17
5121	RHION VERSICHERUNG	163,030	1
5125	SIGNAL IDUNA ALLG.	702,482	6
5036	SV SPARK.VERSICHER.	1,043,874	9
5459	UELZENER ALLG. VERS.	202,683	1
5042	VERSICHERUNGSK.BAYERN	15,801	7
5400	VGH LAND.BRAND.HAN.	778,529	6
5862	VHV ALLGEMEINE VERS.	1,399,880	13

! Please refer to the “Explanatory notes on the statistics” on page 225.

Reg. no.	Name of insurance undertaking	Number of insured risks as at 31 Dec. 2015	Complaints
5484	VOLKSWOHL-BUND SACH	149,246	2
5082	WALDENBURGER VERS.	n.a.	1
5093	WESTF.PROV.VERS.AG	825,116	5
5525	WGV-VERSICHERUNG	350,076	1
5479	WÜRTT. GEMEINDE-VERS.	274,397	2
5783	WÜRTT. VERS.	1,182,183	9
5476	WWK ALLGEMEINE VERS.	142,981	8

! Please refer to the “Explanatory notes on the statistics” on page 225.

4.6 Accident insurance

Reg. no.	Name of insurance undertaking	Number of insured risks as at 31 Dec. 2015	Complaints
5342	AACHENMÜNCHENER VERS.	2,501,109	5
5498	ADAC - SCHUTZBRIEF VERS.	3,682,482	6
5312	ALLIANZ VERS.	3,995,596	36
5405	ALTE LEIPZIGER VERS.	64,734	2
5455	ARAG ALLG. VERS.	20,848,588	3
5515	AXA VERS.	682,986	5
5792	BADEN-BADENER VERS.	262,038	2
5317	BARMENIA ALLG. VERS.	141,790	2
5633	BASLER SACH AG	385,922	14
5310	BAYER. BEAMTEN VERS.	100,986	1
5324	BAYER.VERS.VERB.AG	909,113	3
5338	CONCORDIA VERS.	348,204	3
5340	CONTINENTALE SACHVERS	593,781	5
5311	DBV DT. BEAMTEN-VERS.	210,190	3
5549	DEBEKA ALLGEMEINE	1,925,138	9
5513	DEVK ALLG. VERS.	906,682	1
5562	ERGO DIREKT	237,689	5
5472	ERGO VERSICHERUNG	2,097,520	31
5470	FAHRLEHRERVERS.	n.a.	1
5473	GENERALI VERSICHERUNG	2,517,162	8
5858	GOTHAER ALLGEMEINE AG	687,747	2
5096	HDI GLOBAL SE	49,561	1
5085	HDI VERSICHERUNG	491,798	4
5384	HELVETIA VERS. (CH)	120,553	2
5086	HUK24 AG	n.a.	1
5375	HUK-COBURG UNTER.	963,132	1
5521	HUK-COBURG-ALLG. VERS	667,650	1
5780	INTERRISK VERS.	460,977	2
5078	JANITOS VERSICHERUNG	166,819	1
5412	MECKLENBURG. VERS.	160,786	2
5426	NÜRNBG. ALLG.	508,108	12
5686	NÜRNBG. BEAMTEN ALLG.	69,923	1
5074	PB VERSICHERUNG	n.a.	2
5095	PROV.RHEINLAND VERS.	2,477,693	2
5583	PVAG POLIZEIVERS.	317,141	1
5438	R+V ALLGEMEINE VERS.	1,428,479	5
5125	SIGNAL IDUNA ALLG.	1,696,049	24
5781	SPARK.-VERS.SACHS.ALL	92,014	1
5586	STUTTGARTER VERS.	444,831	9
5036	SV SPARK.VERSICHER.	277,004	1
5484	VOLKSWOHL-BUND SACH	170,123	1
5461	VPV ALLGEMEINE VERS.	158,885	2
5093	WESTF.PROV.VERS.AG	845,345	4
5783	WÜRTT. VERS.	711,959	2
5590	WÜRZBURGER VERSICHER.	n.a.	1
5476	WWK ALLGEMEINE VERS.	264,133	10

! Please refer to the “Explanatory notes on the statistics” on page 225.

4.7 Household contents insurance

Reg. no.	Name of insurance undertaking	Number of insured risks as at 31 Dec. 2015	Complaints
5342	AACHENMÜNCHENER VERS.	936,880	6
5312	ALLIANZ VERS.	2,465,356	22
5405	ALTE LEIPZIGER VERS.	120,312	1
5068	AMMERLÄNDER VERS.	284,140	8
5455	ARAG ALLG. VERS.	784,135	4
5397	ASSTEL SACH	n.a.	1
5077	AXA ART VERSICHERUNG	n.a.	1
5515	AXA VERS.	984,163	16
5633	BASLER SACH AG	252,089	6
5310	BAYER. BEAMTEN VERS.	n.a.	2
5324	BAYER.VERS.VERB.AG	539,261	2
5098	BRUDERHILFE SACH.AG	181,059	1
5339	CONDOR ALLG. VERS.	n.a.	1
5340	CONTINENTALE SACHVERS	207,188	3
5311	DBV DT. BEAMTEN-VERS.	310,432	3
5632	DELVAG VERS.-AG	n.a.	1
5513	DEVK ALLG. VERS.	914,216	6
5344	DEVK DT. EISENB. SACH	423,674	1
5328	DOCURA VVAG	n.a.	1
5472	ERGO VERSICHERUNG	1,023,288	16
5024	FEUERSOZIETÄT	112,453	1
5473	GENERALI VERSICHERUNG	1,233,158	6
5858	GOTHAER ALLGEMEINE AG	705,726	8
5372	GOTHAER VERS.BANK	n.a.	1
5365	GVO GEGENSEITIGKEIT	n.a.	3
5501	HANSEMERKUR ALLG.	n.a.	1
5085	HDI VERSICHERUNG	713,721	15
5384	HELVETIA VERS. (CH)	242,403	1
5086	HUK24 AG	235,745	3
5375	HUK-COBURG UNTER.	1,422,328	9
5521	HUK-COBURG-ALLG. VERS	892,008	3
5573	IDEAL VERS.	n.a.	2
5780	INTERRISK VERS.	187,903	1
5401	ITZEHOER VERSICHERUNG	86,655	1
5078	JANITOS VERSICHERUNG	108,991	1
5404	LBN	113,645	4
5013	LEHRER-FEUER SCHL.-H.	n.a.	1
5402	LVM SACH	796,843	5
5061	MANNHEIMER VERS.	62,574	1
5412	MECKLENBURG. VERS.	182,922	2
5426	NÜRNBG. ALLG.	158,333	3
5446	PROV.NORD BRANDKASSE	268,319	3
5095	PROV.RHEINLAND VERS.	501,278	4
5438	R+V ALLGEMEINE VERS.	1,050,524	5
5773	SAARLAND FEUERVERS.	n.a.	1
5491	SCHLESWIGER VERS.V.	n.a.	1
5125	SIGNAL IDUNA ALLG.	322,969	3
5036	SV SPARK.VERSICHER.	505,700	3
5400	VGH LAND.BRAND.HAN.	480,652	1
5862	VHV ALLGEMEINE VERS.	382,064	1
5484	VOLKSWOHL-BUND SACH	n.a.	1

! Please refer to the “Explanatory notes on the statistics” on page 225.

Reg. no.	Name of insurance undertaking	Number of insured risks as at 31 Dec. 2015	Complaints
5093	WESTF.PROV.VERS.AG	561,680	5
5525	WGV-VERSICHERUNG	154,218	1
5479	WÜRTT. GEMEINDE-VERS.	187,185	2
5476	WWK ALLGEMEINE VERS.	n.a.	8

! Please refer to the "Explanatory notes on the statistics" on page 225.

4.8 Residential building insurance

Reg. no.	Name of insurance undertaking	Number of insured risks as at 31 Dec. 2015	Complaints
5342	AACHENMÜNCHENER VERS.	394,466	2
5312	ALLIANZ VERS.	2,401,880	21
5405	ALTE LEIPZIGER VERS.	118,937	7
5068	AMMERLÄNDER VERS.	n.a.	1
5455	ARAG ALLG. VERS.	108,830	2
5515	AXA VERS.	653,814	31
5317	BARMENIA ALLG. VERS.	n.a.	1
5633	BASLER SACH AG	166,684	13
5310	BAYER. BEAMTEN VERS.	n.a.	2
5319	BAYER. HAUSBESITZER	28,828	3
5043	BAYER.L-BRAND.VERS.AG	2,090,667	5
5324	BAYER.VERS.VERB.AG	830,131	14
5146	BGV-VERSICHERUNG AG	57,017	1
5338	CONCORDIA VERS.	204,978	1
5339	CONDOR ALLG. VERS.	128,635	5
5340	CONTINENTALE SACHVERS	126,137	4
5552	COSMOS VERS.	n.a.	1
5311	DBV DT. BEAMTEN-VERS.	189,423	2
5513	DEVK ALLG. VERS.	385,236	5
5344	DEVK DT. EISENB. SACH	181,232	1
5522	DOLLERUP.FREIE BRANDG	n.a.	5
5472	ERGO VERSICHERUNG	408,688	12
5024	FEUERSOZIETÄT	82,526	2
5473	GENERALI VERSICHERUNG	562,280	14
5858	GOTHAER ALLGEMEINE AG	324,332	8
5485	GRUNDEIGENTÜMER-VERS.	80,054	7
5085	HDI VERSICHERUNG	291,679	19
5384	HELVETIA VERS. (CH)	161,146	6
5086	HUK24 AG	81,544	1
5375	HUK-COBURG UNTER.	663,049	3
5521	HUK-COBURG-ALLG. VERS	264,943	5
5546	INTER ALLG. VERS.	n.a.	1
5401	ITZEHOER VERSICHERUNG	50,769	2
5402	LVM SACH	610,224	13
5061	MANNHEIMER VERS.	52,630	3
5412	MECKLENBURG. VERS.	106,594	4
5334	MEDIENVERS. KARLSRUHE	n.a.	1
5014	NEUENDORFER BRAND-BAU	n.a.	1
5446	PROV.NORD BRANDKASSE	301,761	3
5095	PROV.RHEINLAND VERS.	550,554	11
5583	PVAG POLIZEIVERS.	n.a.	1
5438	R+V ALLGEMEINE VERS.	1,015,862	20
5121	RHION VERSICHERUNG	45,768	1
5773	SAARLAND FEUERVERS.	75,385	1
5491	SCHLESWIGER VERS.V.	n.a.	5
5125	SIGNAL IDUNA ALLG.	185,971	7
5036	SV SPARK.VERSICHER.	1,752,785	33
5042	VERSICHERUNGSK.BAYERN	n.a.	1
5400	VGH LAND.BRAND.HAN.	474,272	4
5862	VHV ALLGEMEINE VERS.	130,262	3
5461	VPV ALLGEMEINE VERS.	64,482	2
5082	WALDENBURGER VERS.	n.a.	1
5093	WESTF.PROV.VERS.AG	591,026	10
5525	WGV-VERSICHERUNG	80,237	7
5479	WÜRTT. GEMEINDE-VERS.	86,055	1
5783	WÜRTT. VERS.	457,129	11

! Please refer to the “Explanatory notes on the statistics” on page 225.

4.9 Legal expenses insurance

Reg. no.	Name of insurance undertaking	Number of insured risks as at 31 Dec. 2015	Complaints*
5826	ADAC-RECHTSSCHUTZ	2,273,747	7
5809	ADVOCARD RS	1,527,637	45
5312	ALLIANZ VERS.	2,403,861	30
5405	ALTE LEIPZIGER VERS.	336,859	28
5455	ARAG ALLG. VERS.	n.a.	1
5800	ARAG SE	1,423,702	235
5801	AUXILIA RS	534,073	17
5838	BADISCHE RECHTSSCHUTZ	169,307	3
5310	BAYER. BEAMTEN VERS.	n.a.	1
5146	BGV-VERSICHERUNG AG	n.a.	3
5831	CONCORDIA RS	413,967	13
5340	CONTINENTALE SACHVERS	120,868	9
5802	D.A.S. ALLG. RS	n.a.	7
5343	DA DEUTSCHE ALLG.VER.	n.a.	2
5549	DEBEKA ALLGEMEINE	415,702	9
5803	DEURAG DT. RS	1,234,052	42
5829	DEVK RECHTSSCHUTZ	1,089,394	22
5834	DMB RECHTSSCHUTZ	803,080	13
5472	ERGO VERSICHERUNG	2,298,857	39
5858	GOTHAER ALLGEMEINE AG	n.a.	1
5365	GVO GEGENSEITIGKEIT	n.a.	1
5085	HDI VERSICHERUNG	n.a.	1
5086	HUK24 AG	112,410	3
5818	HUK-COBURG RS	1,683,785	20
5573	IDEAL VERS.	n.a.	5
5401	ITZEHOER VERSICHERUNG	n.a.	1
5812	JURPARTNER RECHTSSCH.	n.a.	1
5402	LVM SACH	770,238	4
5412	MECKLENBURG. VERS.	145,125	8
5334	MEDIENVERS. KARLSRUHE	n.a.	1
5805	NEUE RECHTSSCHUTZ	447,446	12
5426	NÜRNBG. ALLG.	n.a.	1
5813	OERAG RECHTSSCHUTZ	1,700,751	112
5438	R+V ALLGEMEINE VERS.	768,223	9
5807	ROLAND RECHTSSCHUTZ	1,784,873	46
5459	UELZENER ALLG. VERS.	n.a.	1
5400	VGH LAND.BRAND.HAN.	204,182	3
5461	VPV ALLGEMEINE VERS.	n.a.	1
5093	WESTF.PROV.VERS.AG	n.a.	3
5525	WGV-VERSICHERUNG	432,630	91
5783	WÜRTT. VERS.	682,530	5

* Please note that the figures for the three insurance undertakings with the highest number of complaints include a large number of multiple submissions by one law firm relating to similar subject matters (cover for legal action in connection with the VW emissions scandal).

! Please refer to the "Explanatory notes on the statistics" on page 225.

4.10 Insurers based in the EEA

Reg. no.	Abbreviated name of insurance undertaking	Comp-laints
5902	ACE EUROPEAN (GB)	20
7985	ADVIGON VERS. (LI)	16
5163	AIG EUROPE LIMITED (GB)	11
5029	AIOI NISSAY (GB)	2
5116	AMT MORTGAGE (GB)	2
7509	AMTRUST INT. (IE)	5
5119	ASSURANT ALLG. (GB)	1
5064	ATRADIUS KREDIT (NL)	1
7459	AVIVA LIFE (GB)	1
5636	AWP INTERNATION. (F)	31
5090	AXA CORPORATE S. (F)	2
7775	AXA FRANCE VIE (F)	1
1319	AXA LIFE EUR.LTD(IRL)	1
9374	AXA LIFE EUROPE (IE)	4
7811	CACI LIFE DAC (IE)	3
7807	CACI NON-LIFE (IE)	1
7786	CANADA LIFE (IE)	3
1300	CANADA LIFE (IRL)	8
1182	CARDIF LEBEN (F)	10
5056	CARDIF VERS. (F)	7
5142	CHUBB INSUR. (GB)	6
7690	CIGNA LIFE (B)	1
1189	CIGNA LIFE INS. (B)	1
9306	CNP SANT. (IE)	7
9307	CNP SANTANDER (IE)	18
7724	CREDIT LIFE INT. (NL)	1
5048	DOMESTIC AND GEN. (GB)	11
7309	DONAU VERSICHERUNG(A)	1
7637	ERGO VERS. (A)	1
5115	EUROMAF SA (F)	4
7231	EUROP ASSISTANCE (FR)	10
5053	FINANCIAL INSUR.(GB)	1
9283	FRIENDS LIFE LIM. (GB)	1

Reg. no.	Abbreviated name of insurance undertaking	Comp-laints
7203	FWU LIFE (LU)	4
7268	GENERALI VERS.AG (A)	1
5072	IF SCHADENVERS. (S)	1
7688	INORA LIFE (IRL)	1
7956	INTER PARTNER (B)	10
5788	INTER PARTNER ASS.(B)	2
7587	INTERN.INSU.COR.(NL)	1
7031	LEGAL/GENERAL ASS(GB)	6
9031	LIBERTY EURO.(IRL/E)	8
9139	LIECHTENSTEIN L. (FL)	2
5592	LLOYD'S VERS. (GB)	1
5130	MAPFRE ASISTENC.(E)	6
9313	METLIFE EUROPE (IE)	7
1323	MONUTA VERS. (NL)	3
7723	PRISMALIFE AG (FL)	6
1317	R+V LUXEMB. LV (L)	2
7415	R+V LUXEMBOURG L (L)	2
9158	RCI INSURANCE (MT)	1
7453	SCOTT. WID. (GB)	19
9257	SN SECURECORP (MT)	1
5174	SOCIETATEA (RO)	1
5128	SOGECAP DNL (F)	1
1320	STANDARD LIFE (GB)	9
7763	STONEBRIDGE (GB)	7
1328	SWISS LIFE PROD.(L)	1
5157	TELEFONICA INSURANCE (L)	54
7883	TELEFONICA INSURANCE (LU)	1
7829	UVM VERZEKERING.(NL)	1
1311	VDV LEBEN INT. (GR)	1
7456	VDV Leben International	1
7643	VIENNA-LIFE (FL)	1
7483	VORSORGE LUXEMB. (LU)	1
5151	ZURICH INSURANCE (IRL)	66

! Please refer to the “Explanatory notes on the statistics” on page 225.

5 Memoranda of Understanding (MoUs)

Banking Supervision	
Albania	2012
Argentina	2001
Armenia	2011
Australia	2005
Belgium	1993
Bosnia and Herzegovina	2016
Brazil	2006
China	2004
Denmark	1993
Dubai	2006
El Salvador	2011
Estonia	2002
France	1992
Finland	1995
Georgia	2011
Greece	1993
United Kingdom (BE/FSA)	1995
United Kingdom (SIB/SROs)	1995
United Kingdom (BSC)	1995
Guernsey	2011
Hong Kong	2004
India	2013
Ireland	1993
Italy (BI)	1993
Italy (BI-Unicredit)	2005
Jersey	2012
Jersey	2000
Canada	2004
Qatar	2008
Korea	2006
Kosovo	2011
Croatia	2008
Latvia	2000
Lithuania	2001
Luxembourg	1993
Malta	2004
Macedonia	2011
Mexico	2010
Moldova	2014
Nicaragua	2011
Netherlands	1993
Norway	1995
Austria	2000
Philippines	2007
Poland	2004
Portugal	1996
Romania	2003
Russia	2006
Sweden	1995
Serbia	2011
Singapore	2009
Slovakia	2002
Slovenia	2001
Spain	1993
South Africa	2004
Czech Republic	2003
Turkey	2011
Hungary	2000
USA (OCC)	2000
USA (NYSBD)	2002
USA (FedBoard/OCC)	2000

Banking Supervision	
USA (OTS)	2005
USA (FDIC)	2006
USA (SEC)	2007
Vatican	2014
Vietnam	2010

Securities Supervision	
Argentina	1998
Australia	1998
Brazil	1999
China	1998
Dubai	2006
Estonia	2002
France	1996
Guernsey	2011
Hong Kong	1997
Iran	2016
Italy	1997
Jersey	2012
Jersey	2001
Canada	2003
Qatar	2008
Korea	2010
Croatia	2008
Lebanon	2016
Luxembourg (w/Clearstream)	2004
Monaco	2009
Poland	1999
Portugal	1998
Russia	2001
Russia	2009
Switzerland	1998
Singapore	2000
Slovakia	2004
Spain	1997
South Africa	2001
Taiwan	1997
Czech Republic	1998
Turkey	2000
Hungary	1998
USA (CFTC)	1997
USA (CFTC)	2016
USA (SEC)	1997
USA (SEC)	2007
Vatican	2014
United Arab Emirates	2008
Cyprus	2003

Insurance Supervision	
Egypt	2010
Australia	2005
China	2001
Connecticut (USA)	2011
Dubai	2006
Estonia	2002
Florida (USA)	2009
Georgia (USA)	2012
Guernsey	2011
Hong Kong	2008
Jersey	2012
California (USA)	2007
Canada	2004
Qatar	2008
Korea	2006
Croatia	2008
Latvia	2001
Lithuania	2003
Malta	2004
Maryland (USA)	2009
Minnesota (USA)	2009
Nebraska (USA)	2007
New Jersey (USA)	2009
New York (USA)	2008
Romania	2004
Singapore	2009
Slovakia	2001
Thailand	2010
Czech Republic	2002
Hungary	2002
USA (OTS)	2005
Vatican	2014

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