

# 2017

## Annual Report

Federal Financial  
Supervisory Authority



# BaFin

Bundesanstalt für  
Finanzdienstleistungsaufsicht



# Annual Report 2017

Federal Financial Supervisory Authority  
(Bundesanstalt für Finanzdienstleistungsaufsicht – BaFin)



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# Opinion

## BaFin President Felix Hufeld on integrated supervision

BaFin celebrated a small anniversary in May 2017. Fifteen years previously it had emerged as an integrated supervisory authority formed from the three federal supervisory offices for banking, insurance and securities trading. It had become clear that supervision split over several authorities was no longer appropriate for the times.

That the German legislature is still convinced by the integrated supervision model was made clear when it took the decisions to further strengthen collective consumer protection at BaFin in 2016 and make it the national resolution authority as well at the start of 2018.

And so BaFin is “integrated” in a number of ways: it unifies supervision across all sectors of the financial market, links micro-prudential and macro-prudential supervision, supervises compliance with

rules of conduct (which includes collective consumer protection) and, as already mentioned, is also the national resolution authority. Aside from the clear cost savings – resulting from combined administrative and IT resources and shared centres of competence, for instance – this integration offers other significant advantages:

### **Cross-sectoral supervision**

Parent company in one sector, subsidiary in another, cross-sectoral marketing cooperation, guarantees and so forth – the sectors of the financial market are interconnected in countless ways. An integrated supervisory authority can recognise risks and interdependencies and assess their consequences for the different sectors more quickly than a sector-specific supervisory authority. When the sectors are combined in a single authority, they can share

information directly, agree on a course of action, and act quickly.

What is more, phenomena on the financial market increasingly affect more than one sector. To name just a few prominent examples, the low interest-rate environment, digitalisation, money laundering and Brexit all demonstrate the need for a holistic approach to supervision.

Cross-sectoral supervision also has the advantage that it can establish a uniform interpretation of laws and regulations and apply discretionary scope in a comparable way. Where possible and appropriate, BaFin can define uniform standards and develop consistent administrative practice. The Supervisory Requirements for IT in Financial Institutions (*Bankaufsichtlichen Anforderungen an die IT – BAIT*) is a current example of this. In these requirements, published in 2017, BaFin sets out in detail its expectations of banks as regards IT security. BaFin plans to release the equivalent document for insurance undertakings – the VAIT – in 2018. It almost goes without saying that the requirements for IT that a supervisory authority sets for banks and insurers need to be of a comparable level.

Not only the interpretation and enforcement, but also supervisory law itself needs to be designed in a consistent way when it deals with the same risks – this is important in order to curtail supervisory arbitrage and competitive distortions, among other things. BaFin has these issues on its radar when it participates in the European and global committees for the regulation of the financial market.

#### **Micro-prudential and macro-prudential supervision**

While micro-prudential supervision is concerned with individual companies and the sectors these operate in, the goal of macro-prudential supervision is to secure the stability of the financial system as a whole. BaFin has a well-equipped micro-prudential toolbox, but also has macro-prudential instruments at its disposal, such as the countercyclical capital buffer. Knowledge from micro- and macro-prudential supervision must be transferred and combined without hindrance in order that the supervisors are able to recognise systemic risks at an early stage. This is easier to achieve under one roof, particularly because the boundaries between micro- and macro-prudential supervision are fluid. Micro-prudential tools can have macro-prudential effects – particularly when they are applied across the board. Of particular importance here is the cooperation between the German Federal Ministry of Finance,

the Deutsche Bundesbank and BaFin on the German Financial Stability Committee.

#### **Prudential supervision vs. conduct supervision**

Alongside prudential supervision, a further field of supervision has gained considerable importance, in the wake of the 2007/2008 financial crisis at the very least: conduct supervision. The objective of conduct supervision is to ensure a level playing field for all market participants. Consumers benefit from this too – just as they do from prudential supervision, due to the latter's focus on the solvency of companies and their ability to fulfil their obligations at all times. Particularly in the recent past, a large number of requirements have been issued that are targeted directly at consumer protection. Indirectly, the finance industry benefits from this too: if providers act in the correct way with their customers, the customers' trust in them will grow, which is in turn beneficial for the stability of the financial market. An integrated supervisory authority is in the ideal position to meet the challenge of enabling this interaction to work as it should.

When prudential supervision and conduct supervision share the same roof, this does not just mean that information can flow unimpeded between the two fields and that the supervisors can develop a comprehensive picture of the companies and providers on the financial market. Although that alone would be reason enough for integration. There is also the benefit that the two supervisory fields can agree on their course of action. And should prudential and conduct supervision ever come into conflict, an integrated supervisory authority is particularly well-placed to make carefully balanced decisions.

#### **Resolution vs. supervision**

Resolution and supervision likewise benefit from being able to work independently but united under a single roof, and thereby more efficiently. If a bank gets into difficulties, it is now easier for BaFin to restructure it or – if it is necessary and the requirements are met – to resolve it and thereby prevent negative consequences for the general public. In such cases, every minute counts. Those working in supervision, restructuring and resolution have to act as a well-rehearsed team, which is easier to achieve within a single institution – in particular because, in this case as in others, the national authority, BaFin, tends to act as part of a European team and rarely alone. But it is not just in the dramatic hours either side of a resolution that resolution, restructuring and supervision need to work together seamlessly; it is also important in ongoing supervision, both in resolution planning and if there is a potential need for restructuring.

If a bank goes into freefall, information is also needed from colleagues in securities supervision and insurance supervision. BaFin does not need to first get in touch with a different authority if it wants to find out whether a bank's risks could penetrate through to an insurance undertaking or a fund subsidiary. There are also questions surrounding ad hoc announcements. These and other situations can be analysed and brought under control much more quickly in an integrated supervisory authority.

As an integrated supervisory authority, BaFin has far-reaching powers of intervention, but it too is bound by specific authorisations grounded in law – as is usual in a state under the rule of law. BaFin is not responsible for issues surrounding tax law, for instance. What BaFin does investigate, as appropriate, is the relevant implications under supervisory law of cases of harmful tax practices or criminal activity.





# Key figures at a glance



## 2013 – 2017 key figures at a glance

	2013	2014	2015	2016	2017
<b>Credit institutions <sup>1 2</sup></b>					
<b>Capital resources <sup>3</sup></b>					
Tier 1 capital (€ billion)	476.4	453.0	473.1	489.6	491.2
Own funds (€ billion)	495.8	526.6	544.6	562.0	559.7
Tier 1 capital (% ratio)	16.2%	14.7%	15.3%	15.7%	16.6%
Own funds (% ratio)	16.9%	17.1%	17.7%	18.0%	18.9%
<b>Asset structure and portfolio quality</b>					
Total assets (€ billion) <sup>4</sup>	7,977.5	8,199.8	8,000.7	8,024.3	8,411.2
Total assets (€ billion) <sup>5</sup>	7,955.2	8,176.0	7,975.9	7,995.3	8,379.5
<b>Structure of loans and advances to banks and non-banks (%) <sup>6</sup></b>					
Domestic banks	17.8%	16.2%	15.9%	16.5%	21.4%
Foreign banks	12.5%	12.3%	12.3%	10.9%	9.3%
Non-banks – other financial institutions	1.9%	2.3%	2.4%	2.5%	2.6%
Non-financial companies	16.1%	16.0%	15.9%	16.2%	15.8%
Private households	29.4%	29.9%	30.0%	30.7%	29.3%
Private non-profit organisations	0.3%	0.3%	0.3%	0.3%	0.3%
Public-sector households	6.4%	6.1%	5.8%	5.5%	5.2%
Foreign non-banks	15.6%	16.9%	17.4%	17.4%	16.0%
Amounts due to non-banks as a proportion of loans and advances to non-banks (%) <sup>7</sup>	103.3%	102.1%	103.4%	104.3%	104.3%
Proportion of foreign-currency loans to private households (%) <sup>8</sup>	0.6%	0.5%	0.5%	0.4%	0.3%
Loans in default plus loans on which specific allowances have been recognised before deducting specific allowances as a proportion of loans and advances to banks and non-banks <sup>9</sup>	n/a	3.2%	2.4%	2.2%	1.6%
<b>Structure of equity and liabilities (proportion in %) <sup>10</sup></b>					
Amounts due to domestic banks	14.4%	13.8%	13.4%	13.0%	12.6%
Amounts due to foreign banks	6.8%	6.8%	7.6%	8.2%	7.5%
Deposits from domestic non-banks	40.1%	38.1%	40.3%	41.5%	40.9%
Deposits from foreign non-banks	6.5%	6.0%	6.4%	6.5%	6.4%
Securitised debt incl. subordinated capital	13.5%	12.4%	11.7%	11.3%	15.3%
<b>Income statement structure (in % of average total assets) <sup>11</sup></b>					
Net interest income	1.02%	1.10%	1.11%	1.09%	1.03%
Net commissions received	0.32%	0.35%	0.35%	0.36%	0.37%
General administrative expenses	0.97%	1.01%	1.05%	1.06%	1.09%
Net trading income	0.07%	0.04%	0.04%	0.04%	0.07%
Operating profit/loss before loan loss provisions	0.43%	0.45%	0.44%	0.47%	0.37%
Measurement gains/losses	-0.07%	-0.08%	-0.04%	-0.11%	-0.02%
Operating profit/loss	0.36%	0.37%	0.40%	0.37%	0.36%
Net amount of other and extraordinary income and expense	-0.11%	-0.08%	-0.09%	-0.03%	n/a

	2013	2014	2015	2016	2017
Profit for the year before tax	0.25 %	0.30 %	0.31 %	0.33 %	n/a
Profit for the year after tax	0.17 %	0.21 %	0.21 %	0.24 %	n/a

1 For the number of undertakings under supervision, see Appendix.

2 For further information on credit institutions in Germany, see chapter III.

3 Including financial services institutions.

4 Assets based on balance sheet statistics (*Bilanzstatistik* – BISTA) and data provided under the German Financial and Internal Capital Adequacy Information Regulation (*Verordnung zur Einreichung von Finanz- und Risikotragfähigkeitsinformationen* – FinaRisikoV) (including financial services institutions).

5 Assets based on BISTA.

6 Structure in accordance with BISTA.

7 Based on BISTA and FinaRisikoV data (including financial services institutions).

8 Information based on external status.

9 Based on FinaRisikoV data.

10 Based on BISTA only. The “Securitized debt incl. subordinated capital” item also includes the FinaRisikoV data (financial services institutions etc.).

11 For the years 2013 to 2016, the data has been taken from publications of the Deutsche Bundesbank (results of operations of German credit institutions). Since the data based on 2017 annual financial statements is not yet complete, the figure has been based on FinaRisiko notifications and the income statement structure has been mapped as an approximation.

<b>Insurance undertakings and Pensionsfonds <sup>1 2</sup></b>							
		<b>Life insurers</b>		<b>Private health insurers</b>		<b>Property/casualty insurers</b>	
		2016	2017 <sup>5</sup>	2016	2017 <sup>5</sup>	2016	2017 <sup>5</sup>
Gross premiums written	(€ billion)	85.7	85.6	37.2	39.0	71.0	80.7 <sup>7</sup>
Investments	(€ billion) <sup>3</sup>	882.6	906.1	260.1	272.9	164.9	169.3
Average SCR coverage	(%) <sup>4</sup>	316.3	382.1	418.6 <sup>6</sup>	495.5	288.3	284
<b>Pensionskassen</b>							
		2016	2017 <sup>5</sup>				
Gross premiums earned	(€ billion)	6.9	7.4				
Investments	(€ billion) <sup>3</sup>	154.1	163.5				
Average solvency	(%)	131.2	130.5				
<b>Pensionsfonds</b>							
		2016	2017 <sup>5</sup>				
Gross premiums written	(€ billion)	2.7	2.4				
Investments	(€ billion) <sup>3</sup>	35.4	36.9 <sup>8</sup>				
Beneficiaries		924,074	942,782				
Benefit recipients		297,370	291,165				

1 The figures provided here have been determined on the basis of the Solvency II supervisory regime, which entered into force on 1 January 2016.

Due to the accompanying fundamental change to the system, comparable figures are not always available for the years up to 2016.

2 For information on key figures of the Insurance and Pension Funds Supervision Directorate, see also chapter IV 2.4.

3 Carrying amounts in accordance with the German Commercial Code.

4 A few undertakings are exempt from some of the interim reporting requirements in accordance with section 45 of the Insurance Supervision Act.

5 The data provided is preliminary, because it is based on interim reports and forecasts.

6 Fourth-quarter figure.

7 Figure for business as a whole.

8 Total investments.

	2013	2014	2015	2016	2017
<b>Capital market companies</b> <sup>1 2 3</sup>					
Supervised financial services institutions	702	676	674	708	722
Supervised branches	89	80	86	94	106
Total number of approvals <sup>1</sup>	3,095	1,642	1,682	1,652	1,405
of which prospectuses	396	377	399	348	301
of which registration documents	33	34	32	33	38
of which supplements	2,666	1,231	1,251	1,271	1,066
German asset management companies with authorisation <sup>4</sup>	n/a	113	138	136	136
Registered German asset management companies <sup>4</sup>	n/a	143	218	260	314
Number of investment funds <sup>4</sup>	n/a	5,410	5,649	6,122	6,449
Assets under management there (€ billion) <sup>4</sup>	n/a	1,421	1,743	1,908	2,062

1 Due to the change in data collection method during the period under review, the data is only to a limited extent comparable to prior periods.

2 For the number of undertakings under supervision, see Appendix.

3 For information on key figures of the Securities Supervision/Asset Management Directorate, see also chapter V.

4 "German asset management company" (*Kapitalverwaltungsgesellschaft* – KVG) has only been a defined term in accordance with section 17 of the German Investment Code (*Kapitalanlagegesetzbuch* – KAGB) since 2013, when the Investment Act (*Investmentgesetz*) expired. Due to the accompanying fundamental system change, comparable figures are not always available for the years up to 2013.

#### Legend:

n/a: not available

Tier 1: highest category of own funds

KVG: German asset management company (*Kapitalverwaltungsgesellschaft*)

SCR: solvency capital requirement

FinaRisikoV: German Regulation on the Submission of Financial and Risk-Bearing Capacity Information under the Banking Act (*Verordnung zur Einreichung von Finanz- und Risikotragfähigkeitsinformationen nach dem Kreditwesengesetz*)

FDIs: financial services institutions (*Finanzdienstleistungsinstitute*)

BISTA: balance sheet statistics (*Bilanzstatistik*)

GuV: income statement (*Gewinn- und Verlustrechnung*)

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# Spotlights





## 1 Brexit

**T**he United Kingdom's planned exit from the European Union (EU) is already casting shadows on the financial sector. As a result of Brexit, undertakings domiciled in the UK are expected to lose their European passporting rights, which would also affect a large number of subsidiaries of major non-European banks.

Currently, the European Passport still allows undertakings under UK supervision to conduct banking business and provide other financial services in other member states of the European Economic Area (EEA) as well. Since they want to continue using these passporting rights after Brexit, many of these undertakings are considering relocating to Germany.

BaFin has already held many discussions with such undertakings. It again organised workshops during 2017 for foreign banks and financial services institutions, for funds and their management companies and for foreign issuers of securities to debate supervisory issues. The

workshop agendas included issues such as authorisation procedures, compliance, risk management, outsourcing, internal models, rules for large exposures, recovery planning, marketing notification procedures for funds from third countries as well as the consequences of Brexit for prospectuses. The general feedback from participants was that they had found these events helpful. Furthermore, BaFin has dedicated teams that can be contacted for answers to the wide range of related questions.

### Clarity and a reliable framework

"In a period of transition, supervisors and regulators will need to find novel solutions to ensure a flexible transition into the post-Brexit world", said BaFin President Felix Hufeld. The institutions affected would need reliable transitional arrangements that should not, however, become models for eternity, explained Hufeld. Arrangements that could be tolerated at the start, for instance to avoid cliff effects, would need to be brought into an appropriate balance in the long term. Until that balance was achieved, Hufeld continued, BaFin's aim was to rise to the challenges of the numerous developments in its supervisory practice.

BaFin's aim is to ensure the stability of the German financial market and at the same time offer the undertakings affected by Brexit clarity and support, as well as a reliable framework that allows them to conduct banking business and provide financial services in the EEA, even under the new political conditions. BaFin's President emphasised the importance of ensuring that companies across the EEA are supervised and regulated according to the same standards.

## 2 Digitalisation

Supervisors and regulators, too, must understand the ongoing digital transition. They have to analyse it from a legal and an economic perspective and determine whether and how they must act to safeguard financial stability and protect consumers – both at the level of supervisory administrative practice and at the legislative level.

### Handling of IT risks

Whether internal IT glitches or cyber attacks, IT risks have the potential to be extremely explosive. In order to strengthen its capabilities in this area, BaFin is creating a dedicated unit that will deal with issues of IT security across the industry. Initially, BaFin's focus

was on the banking sector. In cooperation with the Deutsche Bundesbank, BaFin has already scrutinised IT security during a number of on-site inspections at those institutions that are directly under German supervision. The outcome: banks have a lot of catching up to do when it comes to IT security.

In 2017, BaFin also gained an overview of the strengths and weaknesses of insurance undertakings in dealing with cyber risk. Dr Frank Grund, Chief Executive Director of Insurance and Pension Funds Supervision, said that initial results had shown that the approach taken to this issue by a considerable part of the sector was too unsystematic. Reason enough for BaFin to detail and explain its requirements for IT security at banks and insurance undertakings.

### **BAIT – Supervisory Requirements for IT in Financial Institutions**

Like any other operational risk, IT risks are Pillar I risks that banks have to cover by maintaining sufficient capital. In addition to this, they have to manage these risks and in this way ensure IT security.

Published at the beginning of November 2017, the “Supervisory Requirements for IT in Financial Institutions” (*“Bankaufsichtliche Anforderungen an die IT” – BAIT*)<sup>1</sup> set out in detail what BaFin expects in this area from credit and financial services institutions in Germany. Through the BAIT, BaFin has turned IT security into a management issue. The requirements are addressed to senior management and are intended to help institutions to ensure they have a proper system of governance for IT as well.

However, the BAIT are presented in the form of principles rather than a comprehensive catalogue of requirements. BaFin’s aim is to create a clear and flexible framework for the management of IT resources, IT risk and information security. The BAIT are also meant to contribute to raising awareness of IT risk throughout the undertaking – including with respect to outsourcing providers. BaFin has also made transparent in the BAIT what it expects from the institutions in terms of managing and monitoring IT operations.

### **VAIT for insurance undertakings**

In the course of 2018, BaFin will collate and flesh out its requirements for IT in insurance undertakings in a similar way in a document entitled “Supervisory Requirements for IT in Insurance Undertakings”

(*“Versicherungsaufsichtliche Anforderungen an die IT” – VAIT*). Insurance undertakings, too, have to not only maintain adequate solvency capital to cover their IT risks, but also manage these risks appropriately; they owe this to their policyholders.

### **Security also needed for fintech companies**

What applies to the established undertakings of the financial market also goes for fintech companies. No matter how much and what type of technology is used, BaFin always applies the principle of “same business, same risk, same rules”. All providers in the financial market must give IT security the highest priority, because people entrust their money and data to them.

### **IT skills on management boards**

A key concern for BaFin is to ensure that banks and insurers are able to master the challenges of digitalisation with confidence. In order to promote the further expansion of IT knowledge on the management boards of undertakings, BaFin at the end of 2017 amended its administrative practice on the professional qualification of management board members at insurance undertakings and banks under its direct supervision.

In the past, if IT specialists could not provide evidence of banking- or insurance-specific IT knowledge acquired over an extended period, it was difficult for them to be appointed to the management board. Now, a six-month period may be sufficient in specific circumstances.

Independently of this, however, all members of the management board, without exception, still carry overall responsibility and are subject to the due diligence requirements and legal liability rules this entails. “By balancing the requirements for basic professional qualification of all management board managers, which they need in order to exercise their overall responsibility, and the increasing need for specialist know-how, we, the supervisors, are allowing greater scope for appointing IT specialists at management board level”, commented Dr Frank Grund, Chief Executive Director of Insurance and Pension Funds Supervision at BaFin.

### **Outlook**

BaFin has demonstrated in the past, and will continue to do so, that it takes an open and very constructive approach to change and innovation – examples include fintech companies or the fit and proper requirements for chief information officers – but remains true to its role of supervisor and regulator. BaFin’s President Hufeld explains that, given the many different voices of political

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<sup>1</sup> [www.bafin.de/dok/10445406](http://www.bafin.de/dok/10445406).

debate, financial regulators and supervisors have a duty to raise awareness of old and new risks in the interests of both consumers and financial stability. “We’ll have to wait and see to what extent we can make ourselves heard, although success will also depend on how successful we are at finding answers to new and in some cases far-reaching questions.”

From BaFin’s perspective, the following questions arise, for example: How can decentralised business models such as blockchain be supervised? How can BaFin protect the users and clients of such business models? And what will happen to traditional providers in the financial market if participants whose main sources of revenue are outside the financial sector offer financial products with the primary motivation of generating data, without being dependent on the revenue? Who will carry the risk? Are the entities under supervision even the right ones? How should supervisors and regulators deal with the phenomenon of big data analytics? These are some of the many digitalisation issues on which BaFin is working internally – for example in its “Innovations in Financial Technology” unit – as well as in regulatory bodies.

### 3 Consumer protection

Unlike in solvency supervision, which includes a consumer protection remit indirectly, in BaFin’s consumer protection activities the focus is directly on clients and investors. By adopting the Retail Investor Protection Act (*Kleinanlegerschutzgesetz*), legislators have handed a new tool to BaFin which gives it the right to prohibit products or restrict their distribution.

#### **Restrictions on the distribution of CFDs**

In May, for example, BaFin restricted the marketing, distribution and sale of contracts for difference (CFDs). The sale to retail investors of contracts entailing an additional payments obligation has been prohibited since 10 August 2017. “This is the first time we have used the option of product intervention, and represents major progress on one of the most pressing issues in consumer protection”, explained Elisabeth Roegele, Chief Executive Director of Securities Supervision/Asset Management.

People investing in CFDs with an additional payments obligation could lose not only their invested capital, but even some of their other assets or, depending on the leverage effect, everything they own. “A risk we

cannot accept as a consumer protection organisation”, commented Roegele.

#### **Warning about initial coin offerings**

BaFin also provides consumers with information, or issues explicit warnings to them, about risks in the financial market. For example, in November 2017, it issued a warning about the various risks associated with initial coin offerings (ICOs), a highly speculative, but evidently popular form of corporate and project financing. Among other things, BaFin made investors aware that they could lose all their invested capital if they bought coins or tokens in an ICO. BaFin uses the powerful tool of product intervention only as a last resort and after careful consideration.

## 4 Basel III: reforms completed

After lengthy negotiations, the Basel III reforms were finalised in December 2017. The oversight body of the Basel Committee, the Group of Governors and Heads of Supervision (GHOS), formally adopted a compromise, agreeing, among other things, an output floor of 72.5 percent for capital requirements determined by internal models. The main thrust of the revised Basel rules is to curb the unintentionally large deviations in the capital requirements which banks calculate using their internal models.

#### **Compromise on the limits of acceptability**

BaFin President Felix Hufeld, who represents Germany on the GHOS jointly with Bundesbank President Jens Weidmann, remarked that he had not been in favour of an output floor of 72.5 percent, or any output floor for that matter. “The Basel compromise is probably right on the limits of what BaFin could accept with the result that we were just about able to agree”, he said.

Hufeld explained that there had been repeated attempts in recent years to discredit internal models completely and eliminate this risk-sensitive approach. He had always been clear that he would not have agreed to the Basel III compromise if that red line had been crossed. “But we successfully warded off those attempts.” The standardised approach, Hufeld continued, had now been made a lot more risk-sensitive – which is what BaFin and the Bundesbank had advocated – and the use of internal models could continue, even though the risk sensitivity of this approach had been reduced. Now all the member

states of the Basel Committee would have to implement the rules in their national laws – without cherry-picking or watering down any of the standards, emphasised Hufeld.

### **Greater proportionality in the EU**

Traditionally, however, the Basel recommendations are aimed at major banks with international operations, and in the past, most members of the Basel Committee only took this target group into account. The EU, however, had decided to apply the Basel Standards to all banks. This approach has been under review since November 2016: discussions are taking place as to whether and how the regulations can be tailored more proportionately to smaller banks in the EU without compromising on stability.

BaFin is closely involved in these discussions. “It is a matter of particular importance for us to press ahead with the project to ‘venture forwards towards greater proportionality’, shoulder to shoulder with the Federal Ministry of Finance and the Bundesbank”, said Hufeld. Meanwhile, Hufeld continued, a few good proposals had been brought to the European negotiating table, such as a suggestion to create an exemption for development banks, because they fulfilled a public development mandate rather than pursuing any competitive or profit targets. BaFin’s view is that these types of institutions do not need standardised European regulations, but adequate national requirements. The idea of introducing a simplified net stable funding ratio for smaller banks also had merit, added Hufeld. “It would allow us to reduce the operational effort required from small institutions, while retaining access to an effective supervisory tool.” The important objective, explained Hufeld, was to achieve a good result in the upcoming European negotiations using these proposals as a basis – which, as always, was “no mean feat”.

## **5 MiFID II now in force**

Another important regulatory milestone fuelled the debate in 2017: the European reform package consisting of MiFID II<sup>2</sup> and MiFIR<sup>3</sup>, which – together with the

PRIIPs<sup>4</sup> Regulation – brought major changes to conduct regulation in the EU.

Greater transparency, better investor protection – five words give you the gist of what the second Markets in Financial Instruments Directive, MiFID II, alone spells out over hundreds of pages, summarised BaFin President Hufeld, assigning MiFID II to the regulatory super heavyweight division.

### **Too much of a good thing?**

Conduct regulation was another area where the principles of proportionality and appropriateness had to be applied, emphasised the President. “If the new regulations presented an unreasonable burden or caused excessive collateral damage, nobody would benefit”, he explained. But before labelling MiFID II “regulatory overkill” without proper reflection, he continued, we should consider two things:

- There has been an urgent need for action in the relatively recent area of conduct regulation. The new regulations are intended for a sector whose conduct in dealing with clients and in designing and distributing its products has by no means always been perfect. In terms of their approach, therefore, BaFin believes that the reforms are right. For example, MiFID II looks at the entire value chain, from product provider to client, with a view to strengthening its weakest link: the client. In BaFin’s opinion, this is both necessary and the right thing to do.
- Only once MiFID II and other regulatory frameworks have been in use for a while can we assess what their effect really is – separately and taken as a whole. “I wouldn’t be surprised if we also had to make a few subsequent adjustments to MiFID II”, said Hufeld. There was a reason that a review of significant new provisions in the Directive had been scheduled – although this will not happen for another two years or so. “So let’s see how things go.” People who – based on hard facts – pointed out unintended side-effects that required further thought would always find a sympathetic ear at BaFin.

### **Sense of proportion in supervision**

BaFin is aware that the implementation of two regulatory frameworks such as MiFID II and PRIIPs requires major effort. This is why it continues to apply the principle of “supervision with a sense of proportion”, which stood it in good stead in the roll-out of previous comprehensive

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

3 Markets in Financial Instruments Regulation. Regulation (EU) No 600/2014, OJ EU L 173/84.

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4 Packaged Retail and Insurance-based Investment Products Regulation (EU) No 1286/2014, OJ EU L 352/1.



frameworks. President Hufeld: “If someone is seriously trying to implement new rules by the set deadline, but is unable to do so because of IT problems, for example, we won’t bite their head off.” But supervision with a sense of proportion does not give undertakings *carte blanche* to be careless in implementing MiFID II or apply some of the requirements half-heartedly.

## 6 Two years of Solvency II

Solvency II, magnum opus of European insurance supervision, came into force at the beginning of 2016. Insurers have entered a new risk-sensitive world and are managing to navigate it quite well. That was good news, considering how complex the new regime was, said BaFin President Hufeld.

### BaFin sees room for improvement

For 2018, however, BaFin expects the undertakings to deepen their understanding of the new regime. “There are some areas where we have identified room for improvement, such as the ORSA<sup>5</sup> and the SFCR<sup>6</sup>, which is still lacking a bit of depth”, explains Hufeld.

As BaFin had anticipated, the undertakings are still having problems with the principle of proportionality, which is explicitly anchored in the Directive. In Solvency II, regulation has made a departure from the traditional rules-based approach, and BaFin now practises forward-looking and principles-based supervision. First of all, it is for the undertakings to map and – keeping the future in mind as well – adequately mitigate their own risks. BaFin will examine the results and assess them on an individual basis. It is a demanding task for both sides.

### First financial year

German insurance undertakings had to report to BaFin on the first financial year under the new regime, publish their Solvency and Financial Condition Reports and submit their Regular Supervisory Reports (RSRs) on single entities by 22 May 2017. The group-level reports had to be submitted by 3 July 2017.

In-depth analysis of the first set of annual figures has shown that all single entities subject to the reporting obligation are meeting the new requirements. The

solvency capital requirement (SCR) cover ratio amounted to approximately 330 percent on average across all insurance classes. That was good news, said Grund, although he warned that we should not read too much into these ratios: “Even though it is basically possible to compare the figures, they are not suitable for compiling a ranking. Taken in isolation, the information they provide is limited”, he explained.

For example, if insurer A had a solvency ratio of 140 compared with insurer B’s 120 that did not immediately tell us anything about the nature of the portfolios of the two, Grund clarified. It might be that A’s business was much more volatile than B’s. Solvency II is very sensitive to market changes; B with its 120 percent ratio may well, therefore, have the more stable portfolio. What is more, insurance undertakings may adopt different approaches to risk measurement, and they can use transitional measures. “You have to know and understand all that and more to interpret the figures”, said Grund.

Commenting on the Solvency and Financial Condition Reports, Grund remarked: “Solvency II aims to create greater transparency in the insurance sector. We are satisfied with the first round of SFCRs. The results are positive, although there are still a few shortcomings, of course, that will need to be addressed. BaFin and the undertakings are working together to find a solution.”

### Review of the regulatory framework

With Solvency II now in its third year, some parts of it are now undergoing review. “The fact that we are re-examining the framework critically at such an early stage is envisaged in the Directive, and it also makes sense”, said Dr Frank Grund, Chief Executive Director of Insurance and Pension Funds Supervision. Initial experiences had now been gathered and the general environment had changed, he explained.

Grund emphasised that the market value-based approach was not negotiable. “But we want to adjust and improve it”, he added. One example is the standard formula, which BaFin considers to be too complex and is working to simplify. Another factor is that, in some respects, the standard formula is no longer up-to-date. Unlike the internal models, it does not take into account the possibility of negative interest rates, and this may cause undertakings to underestimate their interest rate risk. “Not a good solution in times of persistently low interest rates”, said Grund.

<sup>5</sup> Own Risk and Solvency Assessment.

<sup>6</sup> Solvency and Financial Condition Report (SFCR).

# 7 Low interest rates

## 7.1 Banks

Historically low interest rates continue to be among the major challenges for supervised entities and supervisors alike. The longer they persist, the more they will weigh on the already weak earnings of German banks – especially those institutions whose main source of revenue is net interest income. Most recently, this was confirmed by the low interest rate environment survey initiated by BaFin jointly with the Bundesbank at the beginning of April 2017 (see info box “Survey of German institutions”).

### Continued decline in earnings

Sentiment among the institutions was slightly more optimistic this time than at the time of the 2015 survey, but depending on the scenario, there were again indications of a continued decline in earnings in the German banking industry. All in all, the institutions are expecting pre-tax profits to decline by 9 percent by 2021. If the business volume is expanded by approximately 10 percent, as planned, in the same period, profitability would fall by 16 percent. These developments would be driven in particular by increases expected in valuation allowances, for which an amount of €5.2 billion has been determined for the period to 2021.

### Stress test

In order to estimate how a deterioration in the economic environment could impact on the capital resources of institutions, BaFin also performed a stress test as part of this survey. This involved BaFin examining the resilience of the credit institutions in various stress scenarios, which included interest rate, market and credit risk.

#### Note

### Survey of German institutions

In their 2017 low interest rate environment survey, BaFin and the Bundesbank surveyed Germany's approximately 1,500 small and medium-sized credit institutions under direct German supervision on their results of operations and resilience in the low interest rate environment. These institutions represent approximately 90 percent of all credit institutions in Germany and approximately 40 percent of the aggregate total assets.

The objective of this was to establish how effective the capital adequacy of the credit institutions was in cushioning these stress factors.

### Good resilience in most institutions

An encouraging result was that most small and medium-sized institutions in Germany were more resilient than at the time of the last stress test. “Even in a post-stress scenario, most of the institutions have a strong capital base and continue to be able to exceed their supervisory capital requirements”, explained Raimund Röseler, Chief Executive Director of Banking Supervision. The post-stress Tier 1 capital ratio is 13.3 percent across all participating banks. “However, about 4.5 percent of the participating institutions are unable to meet their Pillar I and II capital requirements plus capital conservation buffer in a stress scenario, even if hidden reserves are taken into account”, cautioned Röseler.

The most evident effect seen in the stress test was the impact a sudden increase in interest rates would have on valuations. Such an increase also had a short-term negative impact on the banks' net interest income. In terms of market risk, the stress test effects are caused by interest-bearing and non-interest-bearing exposures in approximately equal measure. However, non-interest-bearing exposures only account for about one fifth of the portfolio and thus make a disproportionately large contribution to the stress effect. The credit risk stress test shows that the banks are well prepared for a sudden increase in credit risk. In this category, it was above all the positive macro-economic performance that had a beneficial effect.

BaFin uses the risks identified in the stress test to measure the supervisory target equity ratio. This ratio is a valuable early warning indicator for supervisors and as such contributes to further strengthening the stability of the German banking market. BaFin subjects institutions that are particularly vulnerable to even closer supervision.

### Ways out of low earnings

Under growing pressure from low interest rates, banks are increasingly charging fees – “a development which is being viewed critically by the public, who have got used to receiving many banking services for free”, remarked BaFin President Hufeld.

Their attitude was understandable, but short-sighted, he continued: if people wanted to be customers of healthy banks or savings banks, they had to accept that the institutions would impose prices in line with their expenses and open up new sources of income if old

ones dried up. The fact that the most recent low interest rate environment survey has produced a more optimistic result than the two previous ones has shown, at any rate, that these measures can bear fruit. If the economic tailwind lessens, the pressure on institutions' earnings could rise again.

## 7.2 Insurers

"We've often heard the death knell sounded for German life insurance in the past", said Chief Executive Director Grund. Yet, he continued, BaFin's findings still indicated that, fundamentally, the sector did not have any problems in the short or medium term that could threaten its existence – despite the persistently low interest rates that were having a considerable negative impact on the health of life insurers. Even though BaFin believes that the risk management and awareness of insurance undertakings have improved significantly, it continues to subject a number of life insurers to particularly close supervision.

### Living on capital

A growing number of life insurers are living on their capital. They are straining to meet the required contributions to the premium reserve, and consequently to the additional interest provision (*Zinszusatzreserve* – ZZR), which is actually intended to strengthen the undertakings (see info box), from ongoing investment income.

The consequence is that insurers have to realise hidden reserves. Although this is acceptable to a certain extent, because reserve levels are very high at present, hidden reserves are in essence future cash flows. They cannot be realised indefinitely.

### Keep the ZZR ...

Although the ZZR is increasingly becoming a burden on undertakings, to abolish it would be a serious mistake. The *Zinszusatzreserve* gives a systematic boost to the premium reserve. It makes the sector as a whole more robust and underpins its ability to provide guaranteed benefits for the long term. To require insurance undertakings to build up an additional interest provision was therefore still, fundamentally, the right thing to do, emphasised Chief Executive Director Grund.

### ... but make adjustments

However, from BaFin's point of view it is neither necessary nor advisable to continue building this provision at the current rate. "BaFin expects that the way the ZZR is calibrated will be reviewed and adjusted in 2018", explains Grund. "This will also be important when

interest rates rise, because the hidden reserves available to undertakings in such an environment will be lower.

### Trend towards products without fixed guarantees

It is a well-known fact that, in response to the low interest rates, some life insurers no longer offer the traditional policies with fixed guarantees – although others still do. The sector as a whole is moving towards products without fixed guarantees. All in all, it is coming up with a more diversified range of products – which is exactly what BaFin has been calling on it to do for years.

### Is external run-off the answer?

A small number of life insurers have decided to respond to the low interest rates by putting their business into external run-off, which means that they stop taking on new business and sell or transfer parts or the whole of their portfolio. Three run-off platforms are currently active in Germany. One application is currently being assessed by BaFin. No new applications had reached BaFin or been announced by the time of going to press. It would therefore not be appropriate to talk of a major run-off trend at present.

It may at times make good sense to transfer a portfolio – including to specialised run-off providers or operators. But the issue is causing concern among policyholders, even though the undertaking acquiring the portfolio still has to meet all existing contractual obligations and comply with all supervisory regulations.

#### Note

### *Zinszusatzreserve* (ZZR) as part of the premium reserve

Especially for endowment policies such as life and pension insurance, life insurers provide long-term guarantees at premiums that are fixed at the time the contract is entered into. To ensure they can meet these guarantees in a sustainable way, the undertakings have to recognise provisions under commercial law in the form of the premium reserve. To prevent the erosion of their investment income during the low interest rate phase, life insurers have had to build up a *Zinszusatzreserve* (additional interest provision) since 2011. By the end of 2017, the ZZR is expected to have grown to approximately €60 billion – a considerable and fundamental safety cushion for policyholders.

Moreover, no external run-off can take place without BaFin having scrutinised all the details of the arrangement first. "BaFin will only accept a sale or transfer if the interests of policyholders remain protected – in their entirety", emphasised Chief Executive

Director Grund. "If there were even a single policyholder whose interests were not safeguarded, in that they would be worse off as a result of this transaction, we would not give our approval", he said. "We have excellent tools for preventing such cases."

## 8 Timeline of important events in 2017

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January	<ul style="list-style-type: none"><li>▪ BaFin publishes “Circular 01/2017 (WA) – Minimum requirements for the risk management of asset management companies” (<i>Mindestanforderungen an das Risikomanagement von Kapitalverwaltungsgesellschaften – KAMaRisk</i>)</li></ul>
February	<ul style="list-style-type: none"><li>▪ “Circular 2/2017 (VA) – Minimum requirements under supervisory law on the system of governance of insurance undertakings (<i>Mindestanforderungen an die Geschäftsorganisation von Versicherungsunternehmen – MaGo</i>)” enters into force. In this document, BaFin has collated its guidance on key aspects of governance in insurance undertakings.</li><li>▪ BaFin publishes the <b>WpHG Administrative Fine Guidelines II</b>. The amendment was triggered by stricter sanctions introduced by European legislators. The guidelines apply to certain violations in connection with ad hoc disclosures, voting rights notifications and financial reporting.</li></ul>
March	<ul style="list-style-type: none"><li>▪ The European Central Bank (<b>ECB</b>) publishes its “Guidance to banks on <b>non-performing loans</b>”.</li><li>▪ The European Commission presents the <b>Retail Financial Services Action Plan</b>, which is aimed at increasing competition among providers, lowering prices and providing greater choice and better security for consumers.</li><li>▪ The UK’s permanent representative to the EU, Sir Tim Barrow, hands the letter declaring <b>the United Kingdom’s intention to leave the EU</b> to the President of the European Council, Donald Tusk. Under Article 50 of the Treaty of the European Union, this triggers the start of a two-year process in which London and Brussels negotiate the terms of the separation and their future relationship with each other.</li><li>▪ The technical standards supplementing the European <b>Central Securities Depositories Regulation</b> (EU) 909/2014 are published. They enter into force on 29 March 2017.</li><li>▪ 26 regulatory technical standards (RTSs) supplementing the <b>Markets in Financial Instruments Directive, MiFID II</b>, are published in the form of delegated acts in the Official Journal of the European Union. In addition, three delegated acts, “MiFID II Delegated Directive (EU) 2017/593”, “MiFID II Delegated Regulation (EU) 2017/565” and “MiFIR Delegated Regulation (EU) 2017/567” are published in the Official Journal.</li></ul>
April	<ul style="list-style-type: none"><li>▪ <b>BaFin</b> publishes a circular on the requirements for the use of <b>video identification procedures</b>. The security level has been increased; in addition, the procedure can now be used by all entities obliged under the Money Laundering Act (<i>Geldwäschegesetz</i>) that are subject to supervision by BaFin.</li><li>▪ BaFin and the Deutsche Bundesbank launch a <b>survey</b> of 1,555 German credit institutions <b>on their results of operations and resilience in the low interest rate environment</b>.</li><li>▪ In parallel, the European Central Bank (ECB) conducts a <b>profitability review</b> among a small number of German institutions.</li><li>▪ The European Commission publishes the Delegated Regulation (EU) 2017/653 laying down regulatory technical standards with regard to the new <b>key information document for packaged retail and insurance-based investment products</b> (PRIIPs) in the Official Journal.</li></ul>
May	<ul style="list-style-type: none"><li>▪ The ECB publishes its Guide to <b>fit and proper assessments</b> of members of the management bodies of the significant credit institutions.</li><li>▪ The insurance undertakings subject to the Solvency II supervisory regime publish their first <b>Solvency and Financial Condition Reports</b> (SFCRs) and transmit to BaFin the Regular Supervisory Report (RSR) as well as the Quantitative Reporting Templates relating to the past financial year.</li><li>▪ The International Accounting Standards Board (IASB) publishes the final <b>International Financial Reporting Standard 17</b> (IFRS 17 – Insurance Contracts).</li><li>▪ By way of a general administrative act, BaFin imposes restrictions on the marketing, distribution and sale of contracts for difference (<b>CFDs</b>). Pursuant to this act, CFDs with an obligation to make additional payments are prohibited as from 10 August 2017.</li></ul>

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- June
- As a consequence of the first resolution decision taken under the Bank Recovery and Resolution Directive (BRRD), the Single Resolution Mechanism (SRM) transfers **Banco Popular Español** to the Santander Group. At the beginning of June, the SRM had deemed the bank “failing or likely to fail”.
  - **Banca Popolare di Vicenza** and **Veneto Banca** are also classified as “failing or likely to fail”, but they are resolved in accordance with Italian law.
  - As at 30 June 2017, small German institutions also have to report financial information on a quarterly basis under the **ECB Regulation on Reporting of Supervisory Financial Information**. The ECB had amended this Regulation to that effect.
  - The European Commission presents its proposal of a framework on a **pan-European personal pension product** (PEPP).
  - The **Securities Trading Act** (*Wertpapierhandelsgesetz*) is amended. For example, BaFin is given the right to search premises in connection with violations of the prohibition on insider trading and market manipulation. In addition, provisions are put in place stipulating that violations of the prohibition on insider trading and market manipulation committed up to 1 July 2016 must be pursued in accordance with the law applicable at the time of the crime.
  - BaFin completes its market investigation into **payment protection insurance policies** and identifies shortcomings in this process. It publishes the findings of its study, during which it surveyed 30 insurers and 31 banks, on its website on 21 June 2017.
  - At just under €1 billion, the initial public offering of the start-up company **Delivery Hero AG** is the largest IPO of the year.
- 

- July
- The Basel Committee on Banking Supervision (BCBS) publishes the consultative document “**Capital treatment for simple, transparent and comparable short-term securitisations**”. Together with the International Organization of Securities Commissions (IOSCO), it also publishes the consultative document “Criteria for identifying simple, transparent and comparable short-term securitisations”.
  - Together with the Deutsche Bundesbank, BaFin conducts a survey of all German institutions on the potential economic impact of **cum/cum** transactions.
  - The Act Implementing the Second Payment Services Directive (PSD2) (*Gesetz zur Umsetzung der Zweiten Zahlungsdiensterichtlinie*) is promulgated in the Federal Law Gazette. The act transposes into German law the European legal provisions for non-cash payments in the European single market.
  - The European Commission publishes guidelines on the **PRIIPs Regulation**, which are intended as non-binding interpretive guidance.
  - The Act Implementing the Insurance Distribution Directive (**IDD**) and Amending Other Acts (*Gesetz zur Umsetzung der Versicherungsvertriebsrichtlinie und zur Änderung weiterer Gesetze*) is promulgated. It enters into force on 23 February 2018.
  - The **Act to Strengthen Occupational Pensions** (*Betriebsrentenstärkungsgesetz*) is adopted. It creates the option of providing pure defined contribution schemes, under which employers are only obliged to pay contributions.
  - BaFin publishes an analysis of the insurance undertakings’ annual figures and Solvency and Financial Condition Reports (**SFCRs**) on the first financial year under Solvency II. All single entities subject to the reporting obligation meet the new capital requirements.
  - The European Banking Authority (EBA) publishes the results of its second study on the effects of **IFRS 9** (Financial Instruments).
  - The new **EU Prospectus Regulation** enters into force. With few exceptions, the Regulation will apply from 21 July 2019. Certain exceptions for admitting securities to trading on a regulated market have already been applicable since 20 July 2017.
- 

- August
- Following a consultation and preparatory phase lasting several months, the amended **Remuneration Regulation for Institutions** (*Institutsvergütungsverordnung*) enters into force.
  - BaFin publishes two documents for consultation: the draft of a regulation on the minimum requirements for recovery plans for institutions and investment services enterprises (*Rechtsverordnung zu den Mindestanforderungen an Sanierungspläne für Institute und Wertpapierfirmen – MaSan Regulation*) and the draft of a guidance notice on recovery planning.
-

- BaFin sends a questionnaire to all German insurers and *Pensionsfonds* – with the exception of funeral expenses funds – to get an overview of how they **deal with cyber risk**.
  - An amendment to section 13 of the Capital Investment Act (*Vermögensanlagegesetz*) introduces a formal approval process and new content requirements for **capital investments information sheets**. The new regulations apply to both capital investments information sheets submitted together with a prospectus and capital investments information sheets where the public offer can be made without a prospectus, especially in connection with crowdfunding.
- 
- September
- The EBA publishes a discussion paper on the significant risk transfer in **securitisation**.
  - The EBA and the European Securities and Markets Authority (ESMA) publish joint guidelines to assess the **suitability** of members of **management bodies** and **key function** holders.
  - The EBA publishes revised guidelines on **internal governance**.
- 
- October
- BaFin publishes the fifth round of amendments to the Minimum Requirements for Risk Management (*Mindestanforderungen an das Risikomanagement – MaRisk*) for institutions.
  - The guidelines of the Joint Committee of the three European Supervisory Authorities on the prudential **assessment of acquisitions and increases of qualifying holdings** in the financial sector have been applicable since the beginning of October.
  - As part of a G20 initiative to strengthen supervision and regulation of the shadow banking system, the Basel Committee on Banking Supervision publishes **guidelines on identification and management of step-in risk**.
  - The ECB publishes the results of its **stress test**, in which the significant institutions (SIs) had to simulate different interest rate scenarios.
  - As a result of the elimination of the signature requirement, BaFin ceases to accept hard-copy securities prospectuses on 21 October 2017.
- 
- November
- BaFin publishes the Supervisory Requirements for IT in Financial Institutions (*Bankaufsichtliche Anforderungen an die IT – BAIT*).
  - The EBA publishes the methodology for the 2018 **EU-wide stress test**.
  - The German Federal Constitutional Court (*Bundesverfassungsgericht*) rules on the federal government's obligation to respond to **parliamentary questions on financial market supervision**. The court declares that, if there are justified grounds for maintaining confidentiality, the parliamentary right to information, which requires a response to be given in public, can be restricted in exceptional circumstances to the extent that the corresponding questions are not answered in public by applying the Bundestag Rules on Confidentiality.
  - BaFin authorises Eurex Clearing AG to add the clearing of **OTC FX derivatives** to its range of services.
- 
- December
- Regulation (EU) 2017/2402 laying down a **general framework for securitisation** is published.
  - BaFin abolishes the Country Risk Regulation (*Länderrisikoverordnung*) and amends the **Regulation Governing Large Exposures and Loans of € 1 Million or More** (*Großkredit- und Millionenkreditverordnung – GroMiKV*) with effect from 1 January 2018.
  - The reforms of the global Basel III framework are completed. Among other things, an **output floor** is agreed for users of internal models.
  - Regulation (EU) 2017/2395 amending Regulation (EU) No 575/2013 as regards transitional arrangements for mitigating the impact of the introduction of IFRS 9 on own funds and for the large exposures treatment of certain public sector exposures denominated in the domestic currency of any member state is published.
  - BaFin revises its decision criteria for appointing **IT specialists to the management board**.
  - BaFin consolidates the revised **Financial and Internal Capital Adequacy Information Regulation** (*Verordnung zur Einreichung von Finanz- und Risikotragfähigkeitsinformationen*).

- BaFin amends the Liquidity Regulation in order to nullify the national reporting requirements on **liquidity for CRR institutions** in line with European requirements.
  - The delegated acts supplementing the EU Insurance Distribution Directive are published in the form of regulations in the Official Journal of the European Union. They relate to product oversight and governance (**POG**) requirements and conduct of business rules for the sale of insurance-based investment products. The focus is on issues related to conflicts of interest, distribution incentives as well as suitability and appropriateness.
  - The European Insurance and Occupational Pensions Authority (EIOPA) publishes its report on the Europe-wide **stress test** for institutions for occupational retirement provision (**IORPs**).
  - EIOPA publishes the report on long-term guarantee (**LTG**) measures and on measures on equity risk under Solvency II.
  - BaFin publishes guidelines for **liquidity stress tests** of German asset management companies.
-





# II

## Integrated supervision

An abstract graphic consisting of numerous thin, white, overlapping lines that form a complex, flowing pattern across the red background. The lines are most concentrated in the lower right quadrant, creating a sense of movement and depth.



## 1 Brexit

In Brussels, political negotiations started for the period after the United Kingdom leaves the European Union (EU). The negotiations did not produce any concrete results in 2017. An issue of huge importance for companies, financial regulators and policymakers is what shape the United Kingdom's access to the single market of the EU 27 countries, and vice versa, will take in the period after Brexit.<sup>1</sup> Just under half of the UK's total exports go to the EU, making it the UK's largest export market worldwide. Looking at imports shows a similar picture. The issue is even more complex in the financial sector, because London is currently still the central hub for capital flows within the EU.

As things stand at present<sup>2</sup>, the UK is expected to become a third country following Brexit, i.e. it will not be granted special status. Companies as well as national and European supervisory authorities are currently working flat out to prepare for adequately dealing with this challenge.

<sup>1</sup> For details on Brexit, see chapter I 1.

<sup>2</sup> As at the time of going to press, 31 March 2018.

BaFin continued its dialogue with interested companies in the past year and again organised workshops. Scores of banks and financial services institutions are intending to move their offices to Germany and other countries because Brexit will mean that they will lose their European passporting rights that allow them to conduct business in the member states of the European Economic Area (EEA). BaFin and policymakers aim to provide these institutions with guidance for their projects in Germany, offer them legal certainty and, at the same time, ensure the stability of the German financial market.

### Internal models during the transitional period

In total, BaFin has held over 100 consultations with interested companies to date. In this process, it has also made clear the importance it attaches to ensuring that all companies across the eurozone are supervised and regulated in accordance with the same standards. This principle of equal treatment also applies to internal models, which BaFin has to review and approve before institutions are allowed to use them to calculate capital requirements.

Currently, both Germany's BaFin and the Single Supervisory Mechanism (SSM) under the leadership of the European Central Bank (ECB) recognise internal models, if they have already been approved by the UK's Prudential Regulation Authority (PRA). When reviewing

internal models, the PRA applies, until Brexit at least, the same benchmark as BaFin and the ECB: the European Capital Requirements Regulation (CRR). This will allow BaFin and the ECB to tolerate the use of internal models approved by the PRA for a transitional period, initially without conducting comprehensive and time-consuming reviews.

To this end, the German model supervisors at BaFin and the Deutsche Bundesbank – in accordance with European regulations – have specified a multi-stage process for interested institutions, during which they closely partner with the companies in workshops and supervisory interviews (see info box “Rules for internal models”).

BaFin wants to achieve two objectives with this approach: undertakings relocating their operations from London to Germany in response to Brexit can use their internal models approved by the PRA without wasting time. Together with BaFin’s or the SSM’s model supervisors, they will at the same time embark on a process that ensures that the stringent German and European requirements to which internal models are subject are met on a permanent basis.

For a limited period – and in agreement with the ECB – BaFin is also prepared to permit the internal models already approved by the PRA for calculating capital in sister institutions, if certain conditions are met. First of all, the institutions must submit to BaFin the applications required for this purpose, including an action plan. Binding arrangements for further action can only be made once this has been done.

### **Back-to-back models**

Back-to-back models, for example, must not be rejected as a matter of principle. Back-to-back trades occur when EU undertakings conclude transactions in financial instruments and at the same time enter into opposing trades with a company based in London in order to transfer the market price risk. The banks must, however, be able to manage the remaining risk expediently at any time by deploying adequately trained personnel.

Many undertakings also find it convenient for their back office and internal control functions, such as risk control, compliance or internal auditing, to be carried out largely by a company based in London. In these, as in many other cases, outsourcing is possible in principle. Striking the right balance is key. BaFin will not allow undertakings to simply latch on to corporate group structures. The undertakings domiciled in the EU must have appropriate control units. Limits are set on outsourcing, in particular where core areas of the business operation and the control functions are concerned.

Moreover, BaFin surveyed banks and insurance undertakings that operate in Germany under the European Passport. It is currently analysing the undertakings’ responses on business and emergency planning for the exit scenarios.

### **Euro clearing**

Since 2017, euro clearing has been a hot topic. More than 95 percent of all interest rate swaps in euros to date have been cleared through London. On 13 June 2017, the European Commission published its ideas for the

#### Note

### **Rules for internal models**

1. The undertaking, which is domiciled in Germany, applies for the use of an internal model. It provides evidence in its application that the UK’s Prudential Regulation Authority (PRA) has already approved its model. The undertaking also gives information on the current and planned state of development and the quality of the model. In addition, it explains how and by whom the required tasks are to be performed for the model used in Germany. In a plan, it describes how it intends to build the resources and processes needed for this purpose.
2. If BaFin or the SSM believes that the model application is complete and appropriate, it will set a time schedule, taking the undertaking’s plan into account. In this schedule, it will outline the process from tolerating the model approved by the PRA to the regular model review and approval by the German or European supervisory authority.
3. By tolerating the model for a limited period of time, BaFin or the SSM assumes ongoing model supervision.
4. A model review and approval mark the end of this process – providing the undertaking can provide evidence during the review that the regulatory quality requirements on the internal model are met.

## Central counterparties domiciled outside the EU

On 13 June 2017, the European Commission published a proposal for amending the European Market Infrastructure Regulation (EMIR<sup>3</sup>) in relation to the supervision of central counterparties (CCPs); the proposal advocates in particular the strengthening of the role of the European Securities and Markets Authority (ESMA) in the supervision of third-country CCPs. ESMA is in future to be given expanded supervisory powers over third-party CCPs. In future, they are to be allocated to the “not systemically important or not likely to become systemically important (Tier 1 CCP)” or the “systemically important or likely to become systemically important (Tier 2 CCP)” category. The existing third-country arrangements are intended

to be continued only for Tier-1 third-country CCPs. For Tier-2 third-country CCPs, however, further-going requirements are to be introduced. The proposal envisages, for example, that they will have to meet the requirements of EMIR in addition to the national requirements of their home country. Moreover, the European Commission (with the involvement of other bodies, if appropriate) is to be authorised in future, in response to a joint recommendation by ESMA and the competent central bank, to refuse recognition of third-country CCPs of key systemic importance. Third-country CCPs in this category would then have to establish themselves in the EU for clearing purposes (location policy).

stricter supervision of central counterparties domiciled outside the EU (see info box “Central counterparties domiciled outside the EU”).

## 2 Consumer protection

### 2.1 Product intervention

Section 4b of the German Securities Trading Act (*Wertpapierhandelsgesetz*), old version, gave BaFin a legal basis on which it was authorised to issue product intervention measures. This law anticipated Article 42 of Regulation (EU) No 600/2014 (MiFIR), which has been directly applicable since 3 January 2018.<sup>4</sup> With this product intervention tool, BaFin can restrict, or prohibit altogether, the marketing, distribution and sale of certain financial instruments if these present a significant investor protection concern or a threat to the stability or integrity of the financial system or financial market, or a derivative has a negative impact on the price formation mechanism in the underlying markets. In practice, only one of the three criteria, the existence of “significant investor protection concern”, has to date led to product intervention procedures.

### Launch of product intervention procedures

Product intervention procedures may be triggered by insights BaFin has gained in its own market surveillance, prospectus approval procedures or ongoing supervision. In addition, other conceivable triggers for launching product intervention procedures are external sources of information, such as complaints from investors or submissions by consumer protection bodies. Product intervention has now established itself as a fixed component of BaFin’s supervisory practice and has already been used several times.

### Restriction on the distribution of CFDs

By way of the General Administrative Act of 8 May 2017, BaFin imposed restrictions on the marketing, distribution and sale of contracts for difference (CFDs) to retail clients. CFDs may only be offered and distributed to this group of clients if they do not entail any obligation to make additional payments. In this way, the risk of loss for retail clients remains foreseeable, because it is limited to the capital invested.<sup>5</sup>

The parties for which the General Administrative Act is intended were given a three-month period, until 10 August 2017, to implement the restriction. After the expiry of this deadline, BaFin reviewed the Act’s implementation and found that it was not satisfactory in all cases.

<sup>3</sup> For details on EMIR, see the 2016 Annual Report, page 172 ff.

<sup>4</sup> See chapter V 1.1.1.

<sup>5</sup> See chapter I 3.

### **BaFin publishes Guidance Notice**

BaFin therefore published a Guidance Notice on 29 November 2017 with guidelines on implementing the CFD restrictions<sup>6</sup>, highlighting the issues it deemed problematic. The guidelines are intended to help issuers of CFDs to amend their contract terms and conditions in such a way that retail clients are not subject to any additional payments obligation. In particular, BaFin explained once again that issuers must expressly and unconditionally rule out the obligation to make additional payments for retail investors. In addition, it pointed out that it is irrelevant whether the term “additional payments obligation” is used. Other terms, too, such as “deficit”, “shortfall”, “difference” or “negative balance” as well as other paraphrases fall under the prohibition to impose an additional payments obligation if they conceal contract terms and conditions that require retail clients to settle a negative balance on their CFD account.

BaFin will continue to examine on an ongoing basis whether the issuers are complying with the requirements of the General Administrative Act and the guidelines. If necessary, it will enforce compliance by means of administrative enforcement, i. e. by imposing coercive fines, for example.

### **Voluntary undertaking by issuers of credit-linked notes**

The voluntary undertaking by issuers of credit-linked notes shows that product intervention procedures do not necessarily have to end in a restriction or ban in order to accommodate the interests of consumer protection.

In a market investigation conducted in the first half of 2016<sup>7</sup>, BaFin had found that issuers issue credit-linked notes specifically for distribution to retail clients. Compared with other investment products, the structure of credit-linked notes is very complex, because the credit risks of reference undertakings determine the interest rate and repayment of the amount invested. For this and other reasons, BaFin found that the targeted distribution to retail clients was problematic and launched a public hearing in the summer of 2016 on the potential prohibition of the marketing, distribution and sale of credit-linked notes to retail clients.

The industry associations of the issuers affected, the German Banking Industry Committee (*Die Deutsche Kreditwirtschaft*) and the German Derivatives Association

(*Deutscher Derivate Verband*), responded by publishing a voluntary undertaking by the industry to counter the investor protection concerns raised at the hearing.

This prompted BaFin to suspend the planned ban and to monitor – initially for a nine-month period, until the end of September 2017 – whether the industry abided by its voluntary undertaking. With respect to issuance, BaFin did not find any violations. There were only isolated violations of distribution-related principles. These violations were not of a systematic nature, but could be attributed to individual misconduct. Overall, therefore, the industry’s general commitment to abide by the standards of the voluntary undertaking has been confirmed. For this reason, BaFin decided at the end of 2017 to extend the suspension of the ban it had originally intended. However, BaFin will continue to monitor compliance with the voluntary undertaking.

### **Proceedings against individual issuers**

In addition to product intervention by way of the General Administrative Act, BaFin also conducted product intervention proceedings against individual issuers. BaFin discontinued some of the proceedings without issuing a product intervention measure, because it had found during the analysis of the prospectus or as a result of requests for information and submission of documentation that there was at least no “significant investor protection concern” within the meaning of section 4b of the Securities Trading Act, old version (see info box “Request for information and submission of documentation” on page 39). In other cases, the issuers addressed discontinued the offerings concerned of their own accord so there was no need to issue formal product intervention measures.

## **2.2 Market investigations**

### **2.2.1 Payment protection insurance for consumer loans**

In 2017, BaFin concluded its market investigation into payment protection insurance and identified shortcomings in the process (see info box “Focus on payment protection insurance” on page 39).

As BaFin found in its market investigation, payment protection insurance is generally offered as an option when a consumer loan agreement is entered into, and take-up is not mandatory. Approximately two thirds of the banks surveyed indicated that the number of consumer loan agreements without payment protection insurance tended to exceed the number of loans granted with such a policy. However, one

<sup>6</sup> [www.bafin.de/dok/10172246](http://www.bafin.de/dok/10172246).

<sup>7</sup> See 2016 Annual Report, page 35 f.

## Legal background

### Request for information and submission of documentation

At the beginning of 2017, an issuer opposed a request for information and submission of documentation from BaFin by seeking urgent injunctive relief before the Administrative Court (*Verwaltungsgericht*) of Frankfurt am Main. It justified its refusal to provide the information requested in particular by claiming that BaFin, in its request for information and submission of documentation, had not presented sufficient factual indications within the meaning of section 152 of the German Code of Criminal Procedure (*Strafprozessordnung*) to ensure that the requirements for issuing a product intervention measure in accordance with section 4b of the Securities Trading Act were met. In its ruling on the application for urgent injunctive relief, the Administrative Court stated explicitly

that that was not a prerequisite for the lawfulness of a request for information and submission of documentation in accordance with section 4 (3) of the Securities Trading Act. The court found that it merely had to be plausible that BaFin saw a need for questions to examine “whether, to what extent or in what way a measure in accordance with section 4b of the Securities Trading Act seems appropriate or necessary”. “The purpose of requests for information and submission of documentation” was “specifically to ascertain whether the prerequisites for such a measure are met at all”. The Administrative Court considered BaFin’s request for information and submission of documentation to be obviously lawful and therefore rejected the issuer’s application.

third of the institutions sell most of their consumer loan agreements with payment protection insurance. Consumers may get the impression that the loan agreement is conditional on taking out payment protection insurance.

The investigation also revealed that the commission the insurance undertakings pay to the credit institutions is sometimes very high: 12 credit institutions said they received less than 50 percent of the insurance premium. At another 12 banks, the maximum rate of commission was 50 percent, while 7 institutions received more than 50 percent. In a few isolated cases, the commission exceeded 70 percent.

Moreover, the investigation demonstrated that the contract features of payment protection insurance are difficult to understand for consumers. This is because, in many cases, the policyholder is the bank which also brokers the insurance policy rather than the customer. In the absence of explicit legal provisions, this leads to a situation where the obligations to provide information and advice to customers do not apply and customers do not have the right to cancel or withdraw from the policy. Ultimately, this means that the undertakings only provide information and only allow consumers to cancel or withdraw from agreements on a voluntary basis. The investigation also revealed that the respective provisions in the general terms and conditions of the banks and insurance undertakings vary greatly – if they exist at all.

This prompted legislators to add legal requirements for more advice, information and transparency for payment protection insurance policies to the German Insurance Contract Act (*Versicherungsvertragsgesetz*). However, the new regulations only entered into force on 23 February 2018.

#### **New regulations in the Insurance Contract Act**

Under section 7d of the Insurance Contract Act, the bank as the policyholder of a group contract of insurance is now subject to the obligations of an insurance undertaking to advise and inform the customer as the person insured. In addition, the customer as the insured person receives the rights of a policyholder, especially the right of revocation. This gives customers the option to review whether

#### Note

### **Focus on payment protection insurance**

In its market investigation into payment protection insurance, BaFin assessed the nature and features of this insurance product. Above all, 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. 30 insurance undertakings and 31 banks took part in the study.

they really need payment protection insurance, and to do so after entering into the agreement. If not, the Insurance Contract Act allows them to withdraw from the corresponding contractual agreement for payment protection insurance. In addition, there are legal requirements for the group insurance contract under which the customer as the person insured must again be reminded in text form of this right to withdraw from the contract one week after the policy declaration has been submitted. When this information is provided, the bank must also make another copy of the product information document available to the customer. This ensures that the customer has ready access to all the important information on the payment protection insurance policy.

Moreover, legislators have put similar regulations in place in section 7a (5) of the Insurance Contract Act for those cases where payment protection insurance is offered as a by-product or as part of a package or of the same agreement, and where the customers themselves are policyholders. Here, too, the insurance undertaking has to inform them in text form one week after submitting their contractual agreement of their right to withdraw from the contract and also send them another copy of the product information document. With these amendments, legislators have brought the regulations into line with those of the group insurance contract.

## 2.2.2 Implementation of leading case law

In 2017, BaFin conducted a market investigation into "Observing higher court decisions on the application of civil law requirements with relevance to consumer protection". It surveyed about 100 supervised undertakings in different industries to find out how they monitor developments in case law and how, where necessary, they implement them in their own business activities. The survey covered private banks, savings banks, cooperative banks, *Bausparkassen*, financial services providers and asset management companies.

The investigation specifically looked into the extent to which the undertakings had set up regular processes for monitoring case law and how they deal with the insights gained.

All the enterprises surveyed said that they actively and systematically monitored developments in case law. In doing so, the undertakings normally make use of several sources of information, such as the daily press, the trade press, court or consultancy firm newsletters as well as training events and seminars. Associations

also support their member institutions by providing circulars or forms. In addition, the undertakings explained in detail what processes they have in place for cases where court rulings are considered relevant to their own business activities. Many undertakings described cases where, in response to court rulings handed down, they made adjustments to the forms used, for example, or to lists of prices and services or business processes.

## 2.2.3 Internal control systems in banks and savings banks

In 2017, the focus of the ongoing supervision of banks and savings banks was on a market investigation into the internal control systems (ICS) of the institutions. BaFin asked over 110 institutions in writing to provide detailed information on the systems and specific controls in the areas of client advice, client information, client order processing and complaints handling. BaFin corroborated the survey results by conducting on-site interviews and reviews at over 40 institutions. One of the aims of the investigation was to get an overview of how the internal control systems work in practice.

Overall, all the institutions surveyed had well-functioning control systems and controls in the business areas under investigation. Shortcomings were only identified in isolated cases: in the review of contacts with clients and business transactions, in the comprehensibility of control activities, in the coordination of control activities of different organisational units, in the transparency of the control status or in the implementation of the escalation procedure. BaFin discussed these isolated instances in detail with the institutions concerned and the associations.

## 2.3 Consumer complaints and enquiries

### 2.3.1 Credit institutions and financial services providers

#### 2.3.1.1 Complaint figures

In 2017, BaFin processed a total of 5,587 submissions relating to credit and financial services institutions (previous year: 5,162); 5,425 of them were complaints and 162 general enquiries (see Table 1 "Complaints by group of institutions" on page 41). The figure also 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 39 information requests about former banks, and especially



their legal successors. The complaints were upheld in 952 cases, including 1 petition.

**Table 1: Complaints by group of institutions**

Group of institutions	Total number of submissions
Private banks	2,640
Savings banks	660
Public sector banks	104
Cooperative banks	696
Mortgage banks	8
<i>Bausparkassen</i>	351
Financial services providers (e.g. leasing and factoring undertakings, etc.)	586
Foreign banks	380

The submissions related to all products and services of the supervised institutions and undertakings. Most of the queries concerned frequently used banking products, such as the current and garnishment protection account, bank transfers and the processing of loan agreements. Other issues raised included the effects of the continuing phase of low interest rates, such as the introduction of negative interest rates on credit balances. Clients were especially critical of increases in existing banking fees or of the introduction of new fees.

### 2.3.1.2 Selected cases

#### Account models and fees

Some consumers approached BaFin because institutions introduced new account models<sup>8</sup> and charged fees for them which had not been levied before. BaFin cannot influence the structures of a bank's account models, and whether and to what extent it charges account management fees. However, some institutions had amended their general terms and conditions without observing the applicable provisions of the German Civil Code (*Bürgerliches Gesetzbuch*) relevant to consumer protection.

For example, clients were not informed comprehensively and accurately about their rights if they did not agree to the proposed contract amendment. It was not pointed

out that – in addition to the option to object – they also have the right to terminate the contract free of charge and with immediate effect (section 675g (2) sentence 3 of the Civil Code). In another case, it was wrongly suggested to clients that they had to terminate the contract in order to avoid the proposed amendment to the general terms and conditions and thus the imposition of account management fees. In fact, the contract must remain valid under the existing terms and conditions if the client objects to the proposed amendment. If the institution is not prepared to accept that, it has to terminate the contract itself; general terms and conditions cannot be amended unilaterally.

In some cases, BaFin found that, despite objections from their clients, credit institutions adjusted the contracts to the amended terms and conditions and charged fees for account services that had previously been free. BaFin made these institutions reimburse the fees they had collected unlawfully.

#### Consumer credit and payment protection insurance

Several submissions also related to general consumer loans with payment protection insurance.<sup>9</sup> Since this affected older borrowers – aged between 46 and 69 –, one-off premiums of up to five-digit amounts were being charged, thus accounting for between around a third and almost half of the amounts financed. Since the one-off premium is included in the loan, interest has to be paid on that as well, making the loan significantly more expensive. For this reason, customers subsequently wanted to withdraw from the payment protection insurance policy and asked for advice and support.

However, BaFin may only take action to protect collective consumer interests (section 4 (1a) of the German Act Establishing the Federal Financial Supervisory Authority (*Gesetz über die Bundesanstalt für Finanzdienstleistungsaufsicht*)). It is not allowed to advise or support individual consumers.

Before entering into a contract, consumers should check carefully what costs they will incur as a result of taking out payment protection insurance and whether such a policy is advisable and makes financial sense. As part of this process, they should above all consider the insurance premium in relation to the loan amount. Payment protection insurance is typically not a mandatory requirement for getting a loan. If consumers have already entered into such a contract, they should

<sup>8</sup> This section does not refer to basic payment accounts, which consumers can use like current accounts, but with special protection provisions.

<sup>9</sup> See 2.2.1.

check whether they have a right of revocation that they may want to exercise.

## 2.3.2 Investment and asset management companies

As part of investment supervision, a total of 145 complaints and queries were received from consumers in 2017. They related to, among other things, amendments to fund rules and the requirement on asset management companies to provide information to investors.

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, the liquidity retained for contingent liabilities, the amount of sale proceeds for fund properties sold, or when to expect the repayment of the funds invested from an open-ended real estate fund for retail investors in liquidation.

The majority of submissions relating to closed-ended funds were about legacy funds managed by asset management companies supervised by BaFin. These legacy funds are, however, not subject to the requirements of the German Investment Code (*Kapitalanlagegesetzbuch*). Some of the complaints about closed-ended funds also involved company law issues, such as approval requirements.

BaFin investigated the reports and, where necessary, invited comments from the supervised undertakings. It also explained the legal framework to the complainants, for example by pointing out alternative ways of dispute

resolution.<sup>10</sup> There was, however, rarely any need to take further supervisory measures.

## 2.3.3 Insurance undertakings

### 2.3.3.1 Complaint figures

In 2017, BaFin completed the handling of 7,367 submissions (previous year: 7,985) relating to the insurance sector. 32.0 percent (previous year: 29.8 percent) of these submissions ended in success for the parties that made them.

7,212 submissions (previous year: 7,830) were attributable to all insurance classes mentioned in Table 2 "Submissions received by insurance class since 2013" put together. They break down into 6,738 complaints, 374 general enquiries and 100 petitions, which reached BaFin via the German Bundestag or the Federal Ministry of Finance (*Bundesfinanzministerium*). The slight decline in the total is mainly due to the fact that, unlike in the previous year, there was no recurrence of the special factor resulting from a large number of multiple entries in legal expenses insurance relating to the emissions scandal complex.

The reasons for complaints vary (see Table 3 "Most frequent reasons for complaints in 2017"). The most frequent reasons were:

**Table 3: Most frequent reasons for complaints in 2017**

Reason	Number
Type of claims handling/delays	1,240
Sum insured	918
Issues of coverage	810

**Table 2: Submissions received by insurance class since 2013**

Year	Life	Motor	Health	Accident	Liability	Legal expenses	Building/ contents	Other classes	Miscellaneous*	Total
2017	1,825	1,508	1,433	219	400	591	603	633	155	<b>7,367</b>
2016	1,817	1,533	1,335	294	460	924	708	759	155	<b>7,985</b>
2015	2,113	1,778	1,267	294	505	722	470	769	1,558	<b>9,746</b>
2014	2,802	1,822	1,545	379	622	675	890	780	1,624	<b>11,139</b>
2013	2,874	1,604	1,927	331	550	635	822	570	1,555	<b>10,868</b>

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

<sup>10</sup> See the 2017 activity report of BaFin's Arbitration Board.

### 2.3.3.2 Selected cases

#### **Risk premium on change to different tariff**

An individual with private health insurance wanted to switch to a cheaper tariff. The existing tariff was marketed in the 1990s in the federal states formed after Germany's reunification; its special terms and conditions made it particularly favourable. The insurer submitted a quotation to switch, with a risk premium of 300 percent, which it justified by claiming that the new tariff provided more benefits. The risk assessment for the requested tariff change was carried out using an IT assessment tool which disregarded the special terms and conditions of the original tariff. A subsequent manual assessment carried out by the insurer in the process of handling the complaint established that a risk premium of only 30 percent should have been levied. Prompted by BaFin, the insurer amended its working guidelines and submitted new quotations to all affected customers.

#### **Tariff to be used when adjusting insurance cover for couples in the event of separation**

The process of adjusting insurance cover following a couple's divorce gave the complainant rights under her husband's life insurance policy. She complained that after the split of the policy her new policy was to have a lower technical interest rate.

However, under section 11 of the German Pension Equalisation Act (*Versorgungsausgleichsgesetz*), the internal split has to ensure that both spouses have an equal share in the rights acquired during the marriage. Accordingly, the new policy must have the same technical interest rate as the original policy.

When this was queried by BaFin, the insurer said that it would adjust the technical interest rate. The undertaking is working on a solution that will automatically make the IT system use the same technical interest rate in future.

### 2.3.4 Securities business

A total 522 complaints (previous year: 493) and 272 written enquiries (previous year: 188) relating to securities transactions were received from investors in 2017.

Most of the complaints were about customer service (including securities account transfers), investment advice, order execution and client information.

Another focus in 2017 was again on complaints about companies domiciled in Cyprus offering cross-border

services. Since BaFin does not supervise these undertakings, it informed the competent authority in the country of origin, the Cyprus Securities and Exchange Commission (CySEC), about the complaints. Although all of these undertakings offered financial contracts for difference (CFDs)<sup>11</sup> or binary options, the complaints were hardly ever about the products themselves. Losses suffered by clients and the institutions' refusal to repay funds were the main reasons for the complaints, most of which go back to issues dating from 2016 or earlier.

In response to the large number of complaints from all over Europe about Cypriot undertakings, a working group involving CySEC was established at ESMA in 2015. Thanks to this working group and the measures taken by CySEC, the number of complaints declined to 30 in 2017 (previous year: 50).

In addition, a number of complaints were lodged by customers claiming that they had received information late, or not at all, about the possibility to trade subscription rights. For this reason, BaFin had a closer look at the process underlying the provision of this kind of information at the institution concerned and criticised some aspects. In consultation with BaFin, the institution is currently adjusting its process in order to provide customers with better information about the option to trade subscription rights in future.

### 2.3.5 Consumer helpline

Citizens can call BaFin's consumer helpline at +49 (0) 800 2 100 500<sup>12</sup>. They continued to make frequent use of this facility: in 2017, the advisers dealt with 19,367 (previous year: 20,088) queries about the financial market, specific issues relevant to consumer protection and problems with banks, insurance undertakings or financial services providers. Of these queries, 34 percent related to the insurance sector and 45 percent to the banking sector. 9 percent of calls concerned securities supervision.

Many callers requested information about the different ways of submitting complaints to BaFin. The helpline agents named the competent authorities and provided information on the status of ongoing complaint procedures. Many callers also asked about arbitration options.

<sup>11</sup> See chapter I 3.

<sup>12</sup> Free from German landline and mobile numbers. This number replaces the previous number, +49 (0) 228 299 70 299, which is still available to callers from abroad.

## 2.4 Supervision of advice and distribution in the securities business

### 2.4.1 Contact with BaFin

As part of its mandate to protect consumers collectively, BaFin monitors the way advice is provided and marketing is conducted in the securities business. Specifically, this involves monitoring compliance with the conduct of business obligations and organisational requirements set out in part 6 of the Securities Trading Act. Visits by BaFin to banks and savings banks are important sources of information in this context.

In 2017, interviews were held in 235 head offices and branches (including tied agents). BaFin talked to 353 investment advisers and 293 sales control employees.

The venues and issues for discussion were, as always, selected on the basis of risk. The market investigation into internal control systems<sup>13</sup> conducted in 2017 was aimed at establishing whether the institutions have adequate control systems. The on-site visits were aimed at expanding on the insights gathered in the preceding survey by talking to those employees tasked with implementing the control processes as part of their day-to-day activities. In addition, BaFin used the visits to establish how the institutions are implementing the voluntary undertaking by the associations when marketing credit-linked notes.<sup>14</sup>

Moreover, some visits were triggered by the need to perform checks at short notice in response to tip-offs from anonymous whistleblowers. Routine checks were carried out in the advice business. For example, BaFin examined 3,865 individual cases to verify whether the requirement was met to recommend financial instruments only if they are suitable; in addition to the investment recommendation, it looked at 885 securities accounts in order to test the recommendation against the securities portfolio before and after the advice was provided.

### 2.4.2 Employee and Complaints Register

The Employee and Complaints Register (see info box “Employee and Complaints Register”) is a proven tool of collective consumer protection. It gives BaFin important insights for the supervision of impropriety and also has

a disciplining effect on both institutions and investment advisers.

#### Employees

By the end of 2017, BaFin had been notified of 142,832 employees (previous year: 149,156; see Table 4 “Number of employees” on page 45). The employee notifications and their identification numbers again gave BaFin a general idea of staff turnover in investment advice and distribution in 2017.

#### Complaints

In 2017, BaFin was notified of 4,353 complaints (previous year: 4,996; see Table 5 “Number of complaints notified” on page 45). BaFin is able to check on the basis of the complaints notified whether investment firms are complying with the conduct of business obligations incumbent on them when advising retail clients. The complaints notified allow BaFin to investigate systemic and individual irregularities.

Since there is no indication from the complaints notified whether they are justified, BaFin continually assesses individual complaints and the respective investment advice records on the basis of risk. These assessments always focus on whether the investment advice provided was suitable for the investor.

#### Legal background

### Employee and Complaints Register

Institutions which provide investment services are required under section 87 of the Securities Trading Act to report their investment advisers, sales officers and compliance officers, for inclusion in the Employee and Complaints Register maintained by BaFin. They must verifiably ensure that these employees have the necessary expertise and are reliable. The Markets in Financial Instruments Directive (MiFID II), which entered into force on 3 January 2018, makes it mandatory throughout Europe to test their expertise and ensure they are reliable.<sup>15</sup> What is noteworthy in the case of investment advisers is that BaFin also receives reports whenever retail clients complain about their investment advice.

<sup>13</sup> See 2.2.3.

<sup>14</sup> See 2.1.

<sup>15</sup> Article 25(1) of MiFID II (OJ of the EU dated 12 June 2015, L 173/408). For more information on MiFID II, see chapter V 1.1.1.

**Table 4: Number of employees<sup>16</sup>****Employees**

as at	31 Dec. 2016	31 Dec. 2017
Private banks	43,148	41,234
Savings banks/Landesbanks	58,500	55,686
Cooperative banks	41,206	38,912
Financial services institutions	6,302	7,000
<b>Total</b>	<b>149,156</b>	<b>142,832</b>

**Sales officers**

as at	31 Dec. 2016	31 Dec. 2017
Private banks	7,017	5,903
Savings banks/Landesbanks	9,536	9,196
Cooperative banks	6,800	6,404
Financial services institutions	370	370
<b>Total</b>	<b>23,723</b>	<b>21,873</b>

**Investment advisers**

as at	31 Dec. 2016	31 Dec. 2017
Private banks	42,576	40,617
Savings banks/Landesbanks	55,545	52,749
Cooperative banks	38,333	36,161
Financial services institutions	5,754	6,443
<b>Total</b>	<b>142,208</b>	<b>135,970</b>

**Compliance officers**

as at	31 Dec. 2016	30 Sep. 2017
Private banks	101	107
Savings banks/Landesbanks	406	394
Cooperative banks	926	876
Financial services institutions	670	693
<b>Total</b>	<b>2,103</b>	<b>2,070</b>

**Table 5: Number of complaints notified<sup>18</sup>**

Complaints	Private banks	Savings banks/ Landesbanks	Cooperative banks	Financial services institutions	Total
2013	4,019	3,234	2,246	221	<b>9,720</b>
2014	2,381	1,994	1,527	947	<b>6,849</b>
2015	1,546	1,691	1,299	104	<b>4,640</b>
2016	1,633	1,837	1,463	63	<b>4,996</b>
2017	1,298	1,701	1,283	71	<b>4,353</b>

If these assessments give rise to doubts about the expertise or reliability of an employee, or if attention is drawn to employees as a result of violations of supervisory requirements, BaFin will initiate investigations.<sup>17</sup>

### 2.4.3 Measures and administrative fine proceedings

In 2017, BaFin investigated in 28 proceedings any findings that indicated that investment advisers and sales officers were unreliable. In another proceeding

<sup>16</sup> 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 firms that were no longer supervised in accordance with part 11 of the Securities Trading Act (sections 63 et seq.) at the time of the database query are not included. The figures presented here may therefore differ from data published previously.

<sup>17</sup> See 2.4.3.

<sup>18</sup> The total number of complaints has been adjusted for the number of corrections reported. Complaints notified by investment firms that were no longer supervised in accordance with part 11 of the Securities Trading Act (sections 63 et seq.) at the time of the data query are not included. Moreover, institutions can move from one group of institutions to another. Another factor is that – unlike the practice in the reports up to 2015 – the figures were produced on the basis of the respective quarterly totals. As a result, the totals for different reference periods (quarters, years or period as a whole) may vary. The figures presented here may therefore differ from data previously published or published elsewhere.

dating from 2017, BaFin prohibited an employee from working as an investment adviser. The evaluation of an employee's reliability is based on the German WpHG Employee Reporting Regulation (*WpHG-Mitarbeiteranzeigeverordnung*), pursuant to which an employee is not deemed reliable if he or she was convicted of certain offences in the previous five years and the judgement was final.

In 2017, BaFin also dealt with 2 warnings. 1 case is still ongoing, while in another BaFin issued a warning to an employee. This warning was based on repeated complaints. Various investment firms had submitted complaints about an investment adviser to the Employee and Complaints Register.<sup>19</sup> The investigation into the nature of the complaint revealed repeated violations of the conduct of business obligations that fell under the responsibility of the employee concerned. The employee's changes of employer could be traced through the Employee and Complaints Register.

BaFin launched 6 new administrative fine proceedings in 2017 because of violations of the conduct of business rules as well as organisational and transparency requirements by investment firms; it also concluded 6 proceedings by imposing an administrative fine.<sup>20</sup> 13 proceedings were discontinued, 12 of them for discretionary reasons. A total of 54 proceedings were still pending from the previous year. The highest total administrative fine imposed on an undertaking in this area was € 120,000.

## 2.5 Cooperation with the financial markets watchdog

The financial markets watchdog (*Marktwächter Finanzen*) was again an important cooperation partner for BaFin on consumer protection issues in 2017. Established in 2015, this watchdog observes and analyses the financial market from the consumers' perspective through five specialised focused consumer protection organisations. As in previous years, meetings were held in 2017 with all markets watchdog teams from Frankfurt, Hamburg, Bremen, Leipzig and Stuttgart. At these meetings, BaFin presented the latest studies and investigations and the markets watchdogs gave information on current cases from the early warning network of the consumer protection organisations.

<sup>19</sup> See 2.4.2.

<sup>20</sup> For information on sanctions imposed by the Securities Supervision Directorate, see also 6 and chapter V 7.

Specific cases were also discussed by BaFin and the representatives of the markets watchdogs, which reported, for example, on their investigations into losses on the unregulated capital market, experience with conducting creditworthiness assessments following the implementation of the Mortgage Credit Directive and with annual statements for life insurance as well as on the results of a special investigation by the markets watchdog into early repayment penalties in real estate financing. In return, BaFin reported on its latest supervisory practice observations and on how it assesses legal issues, among other topics. For example, the meeting with the markets watchdog team from Frankfurt explored whether investments in gold should be considered capital investments, and how BaFin deals with such cases.

## 2.6 International developments

### 2.6.1 PRIIPs and other product information documents

Under the European PRIIPs Regulation<sup>21</sup>, manufacturers of packaged retail and insurance-based investment products (PRIIPs) have to publish key information documents (KIDs; see info box "PRIIPs and KIDs" on page 47). Anyone who sells, or gives advice on, such products will have to provide retail investors with these information documents (PRIIPs KIDs) before they sign a binding contract or offer. The Regulation, which entered into force on 1 January 2018, specifies the form and content of the key information documents. The PRIIPs Regulation applies directly and, being a European legislative act, takes priority over national regulations.

The requirements of the PRIIPs Regulation for KIDs are supplemented by a Delegated Regulation.<sup>22</sup> In addition, the Joint Committee of the three European Supervisory Authorities (ESAs) makes available interpretive guidance in the form of questions and answers (Q&As) and flowcharts.<sup>23</sup> BaFin was involved in drafting the supplementary legislative acts as well as in working on the interpretive guidance as part of the Joint Committee.

In addition to the PRIIPs key information document, other information documents have been developed at

<sup>21</sup> Regulation (EU) No 1286/2014, OJ EU L 352/1.

<sup>22</sup> Delegated Regulation and Regulatory Technical Standards in relation to the presentation, contents, review and revision of these key information documents as well as the conditions for meeting the obligation to provide them.

<sup>23</sup> <https://esas-joint-committee.europa.eu/Pages/Activities/Packaged-Retail-and-Insurance-Based-Investment-Products.aspx>.

## Definition

### PRIIPs and KIDs

PRIIPs stands for packaged retail and insurance-based investment products. Such products are 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. KID is short for "key information document". KIDs are pre-contractual key information documents for retail investors to allow them to understand and compare the fundamental features and risks of PRIIPs.

the European level. They have also been in use since the beginning of 2018.

### IPID

The Implementing Regulation laying down a standardised presentation format for the insurance product information document in Germany for non-life insurance products (property and casualty insurance and including private health insurance) requires insurance undertakings to use an insurance product information document (IPID) that meets the formal requirements of this Implementing Regulation.<sup>24</sup> As a member of the European Insurance and Occupational Pensions Authority (EIOPA), BaFin was actively involved in developing the implementing technical standard on which this Regulation is based.

### Fee information document and statement of fees

On the basis of its mandate under the Payment Accounts Directive (PAD)<sup>25</sup>, the European Banking Authority (EBA) has also developed regulatory technical standards for product information documents. BaFin was also involved in this work. These standards define the terminology of the payment accounts services that are most frequently used in the member states. The implementing technical standards on the "fee information document" and the "statement of fees" contain rules for standardising these information documents throughout the EU. They are aimed at making it easier for consumers to gain

an overview of the costs of account services and to compare them.

The European Commission developed delegated acts on the basis of these drafts prepared by the EBA.<sup>26</sup> Their entry into force on 31 January 2018 marked the start of the nine-month implementation period for institutions and national competent authorities. In Germany, the final part of the German Payment Accounts Act (*Zahlungskontengesetz*), which deals with fee transparency, will therefore enter into force as at 31 October 2018. Payment service providers will then be required to use the standardised terminology and inform consumers using standardised documents, firstly on the expected fees (fee information) prior to the contract and secondly on the costs actually levied (statement of fees) during the current contract and on termination of the contractual relationship.

### 2.6.2 World Investor Week

The first ever World Investor Week (WIW), an initiative of the International Organization of Securities Commissions (IOSCO), was held at the beginning of October 2017. This global event was aimed at educating consumers about financial issues. BaFin's contribution to WIW included a guide to investing for people in retirement (*Geld anlegen im Ruhestand*) and an investment primer written in simple language (*Das Kleine ABC der Geld-Anlage in Leichter Sprache*); both documents are available on [www.bafin.de](http://www.bafin.de).<sup>27</sup> The primer expands BaFin's range of simple-language documents available on its website. As part of WIW, BaFin also published a video about investing on its website, in which representatives of BaFin provide hints on how to make personal preparations for a meeting with the investment adviser.

<sup>24</sup> Implementing Regulation (EU) 2017/1469, OJ EU L 209/19.

<sup>25</sup> OJ EU L 257/214 dated 28 August 2014.

<sup>26</sup> Commission Delegated Regulation (EU) 2018/32 of 28 September 2017 supplementing Directive 2014/92/EU of the European Parliament and of the Council with regard to regulatory technical standards for the Union standardised terminology for most representative services linked to a payment account; Commission Implementing Regulation (EU) 2018/33 of 28 September 2017 laying down implementing technical standards with regard to the standardised presentation format of the statement of fees and its common symbol according to Directive 2014/92/EU of the European Parliament and of the Council as well as Commission Implementing Regulation (EU) 2018/34 of 28 September 2017 laying down implementing technical standards with regard to the standardised presentation format of the fee information document and its common symbol according to Directive 2014/92/EU of the European Parliament and of the Council (OJ L 6/3, 26, 37 dated 11 January 2018).

<sup>27</sup> [www.bafin.de/dok/10044650](http://www.bafin.de/dok/10044650) (only available in German).

## 2.7 Dispute resolution

### Arbitration Board at BaFin

The responsibilities of the Arbitration Board at BaFin were expanded in 2016 by way of section 14 of the German Injunctions Act (*Unterlassungsklagengesetz*). Since then, BaFin's Arbitration Board has dealt not only with disputes in connection with the German Investment Code (*Kapitalanlagengesetzbuch*), but also with disputes relating to banking transactions and financial services subject to the German Banking Act (*Kreditwesengesetz*) that are provided by institutions supervised by BaFin. However, it only does so if no recognised private dispute resolution entity is responsible. The volume of dispute resolution activity has risen as a result. The Arbitration Board publishes an activity report on this work on its website at [www.bafin.de/schlichtungsstelle](http://www.bafin.de/schlichtungsstelle) as at 1 February of each year<sup>28</sup> (only available in German).

### Information requirements for companies regarding dispute resolution

The German Act on Alternative Dispute Resolution for Consumer Disputes (*Verbraucherstreitbeilegungsgesetz*) and the German Regulation on Financial Dispute Resolution Entities (*Finanzschlichtungsstellenverordnung*) set new standards for the information requirements of companies. They specify, among other things, that companies must provide clear and understandable information on their website and in their general terms and conditions about the extent to which they are prepared to engage in out-of-court dispute resolution. The Arbitration Board at BaFin continues to cooperate with other dispute resolution entities on these and other issues at a national and international level.

## 2.8 Payment Accounts Act

### Basic payment account

The legal right to a basic payment account under the Payment Accounts Act has made a significant contribution to enabling all consumers to participate in economic and social life without restrictions. In general, consumers have since then been able to open a basic payment account without particular difficulties. If banks wrongly refuse such a request, BaFin's administrative procedure has proved to be a simple and quick mechanism for consumers to enforce their right under the Payment Accounts Act.

As part of its supervision, BaFin also investigates whether banks meet their obligation to agree reasonable fees for basic payment accounts. If BaFin finds pricing that is unreasonable, it can instruct a bank to bring its fee model in line with the legal requirements. The Payment Accounts Act specifies two criteria for assessing whether fees are reasonable: standard market fees and user behaviour.

### Help with switching accounts and fee transparency

Since September 2016, payment service providers have had to help consumers with switching accounts if they request this. Consumer submissions to BaFin showed that, at first, there were sometimes delays in switching accounts. The reason was that payment service providers initially had difficulty with the new processes. Another factor was that misunderstandings arose among consumers because the form the law requires to be used is very detailed. However, the account switching process is now largely running smoothly. While an average of 12 consumer complaints per month on help with switching accounts were received in 2016, the monthly average in 2017 was 4.8.

The fee transparency regulations will enter into force on 31 October 2018, making it easier for consumers to compare the costs incurred for account services with reasonable effort. Institutions will from then on have to provide standardised, easy-to-understand information on these services.

# 3 Market integrity

## 3.1 Authorisation requirement

Many providers make use of the facility to have their projects reviewed by BaFin to find out whether they are subject to authorisation requirements. BaFin received 1,208 enquiries relating to authorisation requirements in 2017 (previous year: 1,022). It dealt with 923 authorisation queries in the year under review (previous year: 1,150), and those enquiring thus obtained legal certainty as to whether their project required authorisation under the applicable laws (see info box "Authorisation requirements" on page 49).

## 3.2 Exemption from the authorisation requirement

In 2017, BaFin granted 6 undertakings an initial exemption from the authorisation requirement (previous year: 15; see info box "Exemption" on page 49).

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<sup>28</sup> See also the brochure entitled "Arbitration Board at BaFin", which can be accessed at [www.bafin.de](http://www.bafin.de).



BaFin had exempted a total of 358 institutions by the end of 2017.

Exemptions are also possible for institutions domiciled abroad that wish to conduct their business in Germany on a cross-border basis. This requires that, according to BaFin's assessment, such institutions are subject to equivalent supervision in their respective home country. BaFin granted 1 such exemption in the year under review (previous year: 2).

### 3.3 Illegal investment schemes

The systematic fight against illegal investment schemes (see info box "Illegal investment schemes" on page 50) is a prerequisite for maintaining the integrity and stability of the financial centre. It also serves to protect investors and consumers.

Responding to information from a variety of sources, BaFin initiated a total of 1,042 new investigations in 2017 (previous year: 1,113); it concluded 873 proceedings (previous year: 962). If an undertaking refuses to cooperate voluntarily, BaFin can issue a formal request for information and the submission of documents and demand detailed information and the disclosure of documents on all business matters. BaFin made use of this important tool in its investigations in 41 cases (previous year: 34); it imposed coercive fines in 8 cases (previous year: 26). In the course of the investigations, BaFin also obtained 16 search warrants (previous

#### Legal background

### Exemption

Section 2 (4) of the Banking Act authorises BaFin, in particular exceptional circumstances, to exempt, on a one-off basis, undertakings that conduct banking business or provide financial services that are auxiliary or ancillary to their core business, which is otherwise not related to the financial markets, from the authorisation requirement and a catalogue of requirements specified by law, which constitutes the ongoing solvency supervision under the Banking Act. In practice, this kind of exemption is only granted on application. However, not every business model is eligible. The authorisation requirement for a business legally classified as banking business or a financial service is the rule, and BaFin may only waive this requirement at its due discretion in exceptional circumstances. For this reason, BaFin makes use of this authorisation with caution. Each time an exemption is granted, it will only apply to a very narrow business segment, which BaFin has found not to require supervision.

year: 34) and on this basis searched a number of residential and commercial properties at various locations with the assistance of the Deutsche Bundesbank and the federal-state police forces.

#### Legal background

### Authorisation requirement

BaFin's responsibilities include examining the business of new market participants or new business models of established providers to determine whether they require authorisation under supervisory laws. Providers conducting banking business or providing financial services under the German Banking Act (*Kreditwesengesetz*), conducting insurance business under the German Insurance Supervision Act (*Versicherungsaufsichtsgesetz*), providing payment services under the German Payment Services Supervision Act (*Zahlungsdiensteaufsichtsgesetz*) or managing investment funds within the meaning of the German Investment Code (*Kapitalanlagegesetzbuch*) require authorisation for this business. If providers

have already commenced an activity requiring authorisation without having obtained authorisation from BaFin, the Supervisory Authority enforces the authorisation requirement and ensures that the business is discontinued and any transactions wound up immediately.<sup>29</sup> BaFin provides information on this topic on its website at [www.bafin.de](http://www.bafin.de). Depending on the nature of the case, BaFin may file a complaint with the prosecuting authorities against the operators responsible. For providers of new business models, it is expedient to make an initial self-assessment. To help with this process, BaFin has published guidance notices about the various transactions requiring authorisation on its website.

<sup>29</sup> See 3.3.

## Definition

### Illegal investment schemes

The providers of illegal investment schemes operate without the necessary authorisation and try to remove themselves and their activities requiring authorisation from adequate government controls. In most cases, these participants fail to meet the personal, professional and financial criteria required for conducting such business. Legislators have given BaFin extensive powers of investigation and intervention to uncover business conducted without authorisation, order the transactions to be discontinued and wound up, and to warn the public. BaFin's warnings can be accessed at [www.bafin.de](http://www.bafin.de).

If the initial suspicion is confirmed, BaFin can order the immediate cessation and winding-up of the transactions and adopt measures in support of these orders. It can thus issue instructions to implicated companies, such as account-keeping credit institutions, or appoint a liquidator and order coercive fines to be threatened and imposed. BaFin issued 20 prohibitive orders in the year under review (previous year: 18). In 18 cases (previous year: 23), the operators had to be formally instructed to wind up their unauthorised business. As in previous years, it was not necessary in the vast majority of cases to issue formal instructions or order coercive measures in 2017, since the operators voluntarily discontinued their unauthorised business when BaFin intervened.

Objections to formal measures in connection with investigation and prohibition proceedings were raised in 37 cases in the year under review (previous year: 72). BaFin concluded 43 proceedings in 2017 (previous year: 77), 21 of them by issuing formal objection notices (previous year: 49).

In 2017, the competent Administrative Court (*Verwaltungsgericht*) of Frankfurt am Main rejected 1 objection to notices issued by BaFin in summary proceedings; in 1 case, it ordered that the legal remedy should have a suspensory effect. BaFin won the case in 4 principal proceedings, in 1 case, the Administrative Court found in favour of the plaintiff. On appeal, the Higher Administrative Court (*Verwaltungsgerichtshof*) of Hesse concluded 3 appeal proceedings and 1 case in interim relief proceedings. It ruled in favour of BaFin in all these cases.

### 3.4 Unlawful conduct of insurance business by *Reichsbürger*

BaFin has to take action against unlawful insurance transactions conducted by so-called *Reichsbürger* (Reich Citizens) with increasing regularity (see info box "*Reichsbürger*").

The various groups have not only started issuing their own identity documents, commercial licences and driver's licences, but are increasingly also offering their own insurance policies. These range from contents insurance and residential buildings insurance through burglary insurance down to motor vehicle liability insurance and health insurance. Even though these insurance contracts are only meant to be entered into with members of the respective grouping, this still constitutes the unauthorised conduct of insurance business. BaFin systematically takes action against such business. In individual circumstances where it has to issue formal instructions to this end, it also publishes these cases on its website, [www.bafin.de](http://www.bafin.de).

The potential for loss is particularly high in cases where health insurance is offered without authorisation. Depending on the amount of the loss, policyholders may get into so much debt that they cannot repay it from their own resources.

## Definition

### *Reichsbürger*

"*Reichsbürger*" (Reich Citizens) is a collective label used for a large number of groups that, despite ideological differences, have one thing in common: they dispute the existence of the Federal Republic of Germany and refuse to recognise its legal system. The German intelligence agencies estimate that there are approximately 15,000 people in the *Reichsbürger* scene throughout Germany (as at: third quarter of 2017). The intelligence authorities regard around 900 of them as right-wing extremists.<sup>30</sup>

<sup>30</sup> <https://www.verfassungsschutz.de/de/arbeitsfelder/af-reichsbuerger-und-selbstverwalter/zahlen-und-fakten-reichsbuerger-und-selbstverwalter/reichsbuerger-und-selbstverwalter-personenpotenzial-2017>

### 3.5 Contact point for whistleblowers

Since 1 January 2017, whistleblowers have been able to report alleged supervisory law violations to BaFin using an electronic system. Although, on the one hand, this system guarantees absolute anonymity for the whistleblower, on the other it allows BaFin to get in touch with the whistleblower. They remain anonymous, because the system guarantees their anonymity, providing they do not disclose any data that allows them to be traced. It is technically impossible to trace the submission. The existing communication channels (e-mail, post, telephone, in person) continue to be available.

With this anonymous whistleblowing system, BaFin wants to ensure that fear of negative consequences does not prevent any potential whistleblowers from coming forward. The submission of specific information can help to eliminate violations of supervisory law. The system requires an environment in which potential whistleblowers are prepared to share their knowledge and BaFin is able to ascertain whether the information reported is of supervisory significance. By introducing the electronic whistleblowing system, BaFin has improved this environment further.

In 2017, the contact point for whistleblowers received 629 submissions; the electronic whistleblowing system was used by over half of the whistleblowers. Just under half of all the submissions received related to alleged violations by supervised institutions; BaFin is investigating these reports in order to initiate follow-up measures and stop the violations. Just over a quarter of the submissions related to potentially unauthorised business activities, which BaFin is also investigating<sup>31</sup> 33 submissions related to alleged money laundering activities. The other reports related to complaints, which were passed to the consumer protection department for further processing<sup>32</sup>, or to issues for which BaFin is not the competent authority. Some reports did not contain any identifiable facts.

<sup>31</sup> See 3.4.

<sup>32</sup> See 2.3.

## 4 Payment services supervision law

### Implementation of the Second Payment Services Directive

The German Act Implementing the Second Payment Services Directive (*Gesetz zur Umsetzung der Zweiten Zahlungsdiensterichtlinie*) was promulgated in the Federal Law Gazette<sup>33</sup> on 21 July 2017. By way of this act, which entered into force on 13 January 2018, amendments have been made to the German Payment Services Supervision Act (*Zahlungsdiensteaufsichtsgesetz*) (see info box "Information on the Payment Services Supervision Act").

### Changes resulting from the new Payment Services Supervision Act

Two further transaction types are now subject to the authorisation requirement for institutions subject to the Payment Services Supervision Act. Payment initiation services are services that trigger a payment transaction at the customer's request; the account accessed in this process is not held at the payment initiation service provider, but at another institution. Given the increase in online trading, these service providers are becoming increasingly important.

#### Note

### Information on the Payment Services Supervision Act

On 29 November 2017, BaFin published the revised Guidance Notice "Information on the Payment Services Supervision Act" ("*Hinweise zum Zahlungsdiensteaufsichtsgesetz*"), on its website. The Guidance Notice provides detailed information on authorisation and registration requirements for payment services and e-money as well as on industry-wide exemptions; it also explains the notification system, which has been applicable since 13 January 2018. Some important associations, which are named in the Guidance Notice, have agreed to transmit the notification of their members to BaFin on a consolidated basis. After publishing the Guidance Notice, BaFin hosted a conference on 5 December 2017 on the new version of the Payment Services Supervision Act.

<sup>33</sup> Federal Law Gazette I 2017, page 2446.

Another new addition to the catalogue of payment services is the account information service. This is an online service that provides consolidated information on one or more accounts held by a payment service user with other institutions. Where a supervision requirement under the Payment Services Supervision Act previously only applied if access to customer funds was involved, the mere access to data relating to payment accounts has now been placed under supervision for the first time.

In addition, the definition of "*Akquisitionsgeschäft*" (issuing of payment instruments and/or acquiring of payment transactions) has been expanded. The digital payments business will no longer be a payment service subject to separate standards 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.

Finally, in the implementation of the Payment Services Directive, the industry-wide exemptions for certain payment systems and for the telecommunications sector were narrowed down: a payment instrument will in future be exempted from the authorisation requirement only if the ways in which it can be used are limited to a clearly (more narrowly) defined network, a very limited product range or certain social or tax purposes. The telecommunications sector, too, is only exempt from the authorisation requirement for certain types of transactions, provided certain upper limits are not exceeded.

#### **Technical requirements expanded**

For the supervision of payment and e-money institutions, the act has in particular led to expanded technical requirements. For example, processes for handling security incidents, for dealing with sensitive payment data and for ensuring business continuity in crisis situations must be implemented and documented, as do the collection of statistical data and a security strategy. Companies that exclusively provide account information services do not have to get authorisation; instead they only have to apply for registration, although they are then also supervised. Payment initiation and account information service providers need cover, such as liability insurance.

#### **Security of payments**

The security of payments is a topic of major significance in payment transactions. Mandatory strong customer authentication for certain transactions is intended to keep cases of fraud in payment transactions to a minimum. Special requirements imposed on the new

payment service providers for the technical access interfaces to the payment account are intended to allow structured, secure access to payment accounts. The European Banking Authority (EBA) drafted regulatory technical standards, which entered into force on 14 March 2018 as a Delegated Regulation of the European Commission<sup>34</sup>. Payment service providers now have until 14 September 2019 to implement this regulation.

## 5 Money laundering prevention

### 5.1 Closer supervision of money laundering

BaFin further tightened its supervision of money laundering in 2017, establishing two new divisions, which supervise in particular large and complex credit institutions more closely. In addition, BaFin created its own dedicated group of auditors so that it can increasingly use its own personnel to perform money laundering audits. This will allow BaFin to conduct significantly more special audits in the fight against money laundering in coming years. However, these audits will focus on preventive work rather than complete system audits. Early indications from 2017 are encouraging: BaFin's auditors gained their own insights in the field, while employees in the credit institutions used the opportunity to get first-hand information from the supervisors on BaFin's requirements. In 2017, BaFin also intensified the supervision of branches of foreign institutions domiciled in the EU and of subsidiaries of institutions from third countries.

### 5.2 New regulations for video identification

In April 2017, BaFin published a new circular on the requirements for the use of video identification procedures.<sup>35</sup> It replaces the guidance given in item III of Circular 1/2014 (GW). According to the new circular, the video identification procedure may be used by all

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<sup>34</sup> Commission Delegated Regulation (EU) 2018/389 of 27 November 2017 supplementing Directive (EU) 2015/2366 of the European Parliament and of the Council with regard to regulatory technical standards for strong customer authentication and common and secure open standards of communication.

<sup>35</sup> Circular 3/2017 (GW) – video identification procedures.

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

Recipient	2017		2016	
	Absolute	in %	Absolute	in %
BaFin	751	0.5	781	0.6
Tax authorities	13,690	10.0	13,549	9.9
Police authorities	85,331	62.4	88,322	64.4
Public prosecutors	27,812	20.3	26,850	19.6
Customs authorities	8,934	6.5	7,307	5.3
Other	327	0.2	375	0.3
<b>Total</b>	<b>136,845</b>		<b>137,184</b>	

Last updated: 31 December 2017

entities obliged under the German Money Laundering Act (*Geldwäschegesetz*) that are subject to supervision by BaFin.

The circular is intended to ensure secure identification and prevent criminal offences. The requirements for video identification procedures should accommodate customers' calls for seamless identification procedures. At the same time, they should meet the needs of the competent police authorities (police, state offices of criminal investigation) for sufficiently reliable verification of the identity of natural persons pursuant to the Money Laundering Act.

In particular, the circular lays down additional requirements for the technology used in the procedure and for examining the necessary security features. These include end-to-end encryption according to certain criteria.

Under the new circular, an identity verification using a video identification procedure can be performed on the basis of all domestic and foreign identity documents that have a machine-readable zone and contain sufficiently tamper-proof and verifiable optical security features in different categories.

Video and audio recordings of the entire video identification process, in all its individual steps, must be made and retained for five years in a manner that permits verification by internal and external audit and by BaFin. This also applies to photographs and screenshots of the person to be identified and of their identity document. The person to be identified must give their explicit prior consent to this procedure.

### 5.3 Account information access system

Pursuant to section 24c (1) of the German Banking Act (*Kreditwesengesetz*), credit institutions, asset management companies and payment institutions are required to store in a data file certain account master data, such as the account number, name and date of birth of the account holders and authorised users as well as the date of opening and closure. BaFin may retrieve individual items of information from this file insofar as this is necessary for the performance of 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, for example to law enforcement agencies. The statistical data on the number and distribution of requests can be found in Table 6 "Account information access procedures in accordance with section 24c of the Banking Act".

### 5.4 Amended version of the Money Laundering Act

The Act Implementing the Fourth EU Anti-Money Laundering Directive<sup>36</sup>, Interpreting the EU Funds Transfers Regulation and Reorganising the Financial Intelligence Unit (FIU) (*Gesetz zur Umsetzung der Vierten EU-Geldwäscherichtlinie, zur Ausführung der EU-Geldtransferverordnung und zur Neuorganisation der Zentralstelle für Finanztransaktionsuntersuchungen*) of 23 June 2017<sup>37</sup> entered into force on 26 June 2017

<sup>36</sup> Directive 2015/849/EU, OJ EU L 141/73.

<sup>37</sup> Federal Law Gazette I 2017, page 1822.

## Note

### BaFin involved in Level 3 measures

The Fourth Money Laundering Directive and the Funds Transfer Regulation set the three European Supervisory Authorities, EBA, ESMA and EIOPA, a number of tasks to develop Level 3 measures. The drafts in this process are primarily prepared by the Sub-Committee on Anti Money Laundering (AMLC) of the Joint Committee of the three ESAs. Measures developed by members of the AMLC in 2017 included the guidelines on the risk factors<sup>38</sup> and on the application of the Funds Transfers Regulation<sup>39</sup> as well as the Joint Opinion on the risks of money laundering and terrorist financing affecting the EU's financial sector.<sup>40</sup> BaFin played a leading role in this process.

(see info box "BaFin involved in Level 3 measures"). The Act revised the Money Laundering Act of 2008. It is intended to prevent and combat money laundering and terrorist financing more effectively in Germany.

#### Electronic transparency register

The Act created the conditions for a central electronic transparency register. This register went live on 1 October 2017, creating and facilitating access to a record of the beneficial owners of corporations, partnerships and trusts that are active on the financial market. It is intended to increase the transparency of these legal entities and make it more difficult to abuse companies and trusts for the purposes of money laundering or terrorist financing. The register also makes use of information on equity investments stored in existing registers, such as the commercial register or the register of associations (section 22 (1) of the Money Laundering Act).

38 Joint Guidelines under Articles 17 and 18(4) of Directive (EU) 2015/849 on simplified and enhanced customer due diligence and the factors credit and financial institutions should consider when assessing the money laundering and terrorist financing risk associated with individual business relationships and occasional transactions.

39 Joint Guidelines under Article 25 of Regulation (EU) 2015/847 on the measures payment service providers should take to detect missing or incomplete information on the payer or the payee, and the procedures they should put in place to manage a transfer of funds lacking the required information.

40 Joint Opinion on the risks of money laundering and terrorist financing affecting the Union's financial sector.

The register may be accessed by the Financial Intelligence Unit as well as supervisory authorities and law enforcement agencies. Companies and persons that are obliged entities within the meaning of the Money Laundering Act also have access – in fulfilment of their due diligence obligations under money laundering law. Even other individuals and organisations that demonstrate to the entity keeping the register that they have a legitimate interest may view the register.

#### Risk-based approach and group-wide obligations

The amended Money Laundering Act is based on a strong risk-based approach, under which all obliged entities as defined by the Act have to determine both their own risks and group-wide risks if they have subordinated companies in Germany or abroad. This enables not only the companies themselves, but also supervisory authorities to deploy their resources efficiently.

#### Administrative fines and sanctions

Serious, repeated or systematic violations of the Money Laundering Act may now be punished with an administrative fine of up to € 1 million. In such cases, certain obliged entities that are legal persons or associations of individuals may be fined up to € 5 million.

Moreover, the Act gives the competent authorities additional tools, including the option to temporarily prohibit the persons responsible for the violations from exercising management duties at an obliged entity.

## 6 Sanctions

In 2017, BaFin initiated a total of 316 administrative fine proceedings<sup>41</sup> (see info box "New administrative fine proceedings initiated by BaFin" on page 55).<sup>42</sup> The proceedings were launched against natural persons, payment agents, credit institutions, insurance undertakings, payment institutions and institutions engaged in finance leasing and/or factoring<sup>43</sup>, and – where applicable – also against their responsible persons. These concerned violations of the provisions of the German Money Laundering

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

42 For information on the distinction between sanctions and measures, see 2016 Annual report, p. 55 ff.

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

## Note

## New administrative fine proceedings initiated by BaFin

BaFin initiated 316 administrative fine proceedings in 2017:

- 128 were attributable to the Banking Supervision (including money laundering prevention) and Insurance Supervision directorates<sup>44</sup>, and
- 188<sup>45</sup> were attributable to the Securities Supervision/Asset Management Directorate.

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 German Payment Services Supervision Act (*Zahlungsdiensteaufsichtsgesetz*) that are punishable by a fine.

### Amount of the administrative fines

Administrative fines totalling **€ 17,940,850** were imposed across all of BaFin's directorates in 2017 (see info box "Administrative fines imposed by BaFin").

### Administrative fine proceedings – Securities Supervision

In 2017, BaFin's Securities Supervision/Asset Management Directorate imposed administrative fines totalling approximately € 5.64 million<sup>46</sup> for violations of capital markets law<sup>47</sup> (see info box "Administrative fines imposed by BaFin"). The directorate launched 188<sup>48</sup> new administrative fine proceedings; a total of 981 proceedings were still pending from the previous

44 These proceedings were initiated by the Internal Administration and Legal Affairs Directorate. Since the beginning of 2018, money laundering prevention has come under the new Resolution Directorate.

45 These include the figures stated in 2.4.3 and chapter V 7.

46 This total includes the administrative fines stated in 2.4.7 and chapter V 7.

47 This includes violations of the Securities Trading Act, the German Securities Acquisition and Takeover Act (*Wertpapiererwerbs- und Übernahmegesetz*) and the Capital Investment Act. BaFin did not initiate any administrative fine proceedings due to violations of the Securities Acquisition and Takeover Act in 2017.

48 These include the figures stated in 2.4.3 and chapter V 7.

## Note

## Administrative fines imposed by BaFin

In 2017, BaFin imposed administrative fines totalling **€ 17,940,850**:

- Administrative fines totalling **€ 12,300,850** were attributable to the Banking Supervision (including money laundering prevention) and Insurance Supervision directorates.
- The Securities Supervision/Asset Management Directorate imposed a total of **€ 5,640,000** in administrative fines.

year. It concluded a total of 300 proceedings, 96 of them by imposing an administrative fine. The prosecution ratio was approximately 32 percent.<sup>49</sup>

Violations of the obligation to publish ad hoc disclosures were again a focus for Securities Supervision in 2017. 22 new proceedings were initiated in 2017, while 21 cases were concluded. BaFin concluded 11 proceedings by imposing administrative fines and discontinued 10 proceedings. Examples include an administrative fine totalling € 550,000, which BaFin imposed on a German credit institution for 4 violations of the obligation to publish ad-hoc disclosures.

### Administrative fine proceedings – Banking and Insurance Supervision

BaFin<sup>50</sup> launched 37 proceedings against agents within the meaning of section 1 (7) of the Payment Services Supervision Act, old version (now section 1 (9) of the Payment Services Supervision Act) in the year under review. BaFin issued 28 administrative orders imposing a fine in these 37 proceedings and other administrative fine proceedings pending from previous years against agents. In 2017, 26 administrative orders imposing a fine on agents became final, of which 2 in a preliminary hearing following ordinary and extraordinary appeal and 2 further orders as the result of a decision by the court.

At the time of going to press, 1 case of administrative fine proceedings against agents was pending a

49 This statistical data includes the administrative fine proceedings stated in 6.4.3 and chapter V 7.

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

preliminary hearing following a permissible appeal. 10 others were concluded using the warning procedure<sup>51</sup> since, once the investigations were complete, the administrative offences were able to be judged as only minor. BaFin discontinued<sup>52</sup> 12 other proceedings; 1 had to be dismissed due to an impediment to the proceedings. In 2017, BaFin imposed fines totalling €45,300 against agents within the meaning of section 1 (7) of the Payment Services Supervision Act, old version.

Due to violations of 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, BaFin<sup>53</sup> initiated 91 proceedings in accordance with the German Act on Breaches of Administrative Regulations (*Ordnungswidrigkeitengesetz*) in the year under review – against credit institutions, insurance undertakings, payment institutions and institutions that engage in financial leasing and/or factoring.<sup>54</sup> Of these, 78 were attributable to the Banking Supervision Directorate, 2 to the Internal Administration and Legal Affairs Directorate, 3 to the Securities Supervision Directorate and 8 to the Insurance Supervision Directorate.

In the year under review, BaFin issued 38 administrative orders imposing a fine in these proceedings and others pending from previous years: 34 in the Banking Supervision Directorate, 2 in the Securities Supervision Directorate and 2 in the Insurance Supervision Directorate. 26 of these administrative orders imposing a fine became final in 2017 (22 from the Banking Supervision Directorate, 2 from the Insurance Supervision Directorate and 2 from the Securities Supervision Directorate); 7 of these orders were the subject of a court decision (all of these from the Banking Supervision Directorate).

At the time of going to press, 4 proceedings were pending a preliminary hearing (all from the Banking Supervision Directorate). In the year under review, a total of 77 proceedings, some of which had been initiated in prior years, were discontinued, 48 of them for discretionary reasons (45 from the Banking Supervision Directorate, 1 from the Internal Administration and Legal Affairs Directorate and 2 from the Insurance Supervision

Directorate).<sup>55</sup> 32 proceedings were terminated in other ways, for example by issuing warnings, discontinuing proceedings in accordance with section 46 (1) of the Act on Breaches of Administrative Regulations in conjunction with section 170 (2) of the German Code of Criminal Procedure (*Strafprozessordnung*), referrals to public prosecutors' offices in accordance with section 41 (1) of the Act on Breaches of Administrative Regulations (26 from the Banking Supervision Directorate, 1 from the Securities Supervision Directorate and 5 from the Insurance Supervision Directorate).

### **Amount of the administrative fines**

In 2017, BaFin imposed a total of 476 individual administrative fines in a total amount of €12,300,850 against credit institutions, insurance undertakings, payment institutions and institutions that engage in financial 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 Investment Code and the Insurance Supervision Act.

## 7 Digitalisation

### 7.1 IT competency among management board members<sup>56</sup>

Information technology has increasingly been transformed in recent years from providing basic infrastructure for banking and insurance transactions to being a key technology for new value chains.

For BaFin, ensuring that banks and insurance undertakings can effectively tackle the new challenges posed by digitalisation is a matter of pivotal importance. At the end of 2017, BaFin therefore adjusted its administrative practice in relation to the practical experience required by management board members. BaFin thus provides greater flexibility for the appointment of IT specialists when it comes to weighing the increasing need for specialist knowledge against the requirements on the essential professional qualifications that the management board needs in order to fulfil its collective responsibilities.

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

52 Section 47 (1) of the Act on Breaches of Administrative Regulations.

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

54 Or against their responsible persons.

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

56 See BaFinJournal December 2017, pages 15 ff. (only available in German).



### Legal framework

The requirements relating to the professional qualifications of management board members are set out in section 25c (1) of the German Banking Act (*Kreditwesengesetz*) and section 24 (1) of the German Insurance Supervision Act (*Versicherungsaufsichtsgesetz*) are always assessed with consideration for the individual credit institution or insurance undertaking concerned and with the principle of proportionality taken into account. This means that the requirements for the management of an undertaking with a complex business model and risk profile will be different to those for an undertaking that has less intricate business operations.

### Three components of the professional qualifications requirement

In order to be considered professionally qualified under both the Banking Act and Insurance Supervision Act, management board members have to possess the relevant theoretical and practical knowledge of the banking or insurance business as well as management experience.

In order to facilitate the further development of IT know-how at management board level, the period spent gaining necessary practical banking or insurance business experience before assuming a management position may, where appropriate, be reduced to six months for individual assessments of suitability in future. If necessary, the prospective member of the management board should also use this period of at least six months to develop and expand their theoretical knowledge of banking or insurance business, as the professional qualifications requirement must already be fulfilled when they assume their position.

This administrative practice will make it easier for credit institutions and insurance undertakings to further diversify their allocation of responsibilities by creating special IT units and by appointing a management board member for the area of IT (often referred to as a "Chief Information Officer" or "CIO").

### Extensive knowledge of IT

In order for such an easing of the practical experience requirements to be justified, the person responsible for the IT unit must be able to demonstrate extensive theoretical and practical knowledge of this field. BaFin plans to use the Supervisory Requirements for IT in Financial Institutions (*Bankaufsichtliche Anforderungen*

*an die IT – BAIT*)<sup>57</sup> to determine the specific experience required by management board members specialising in IT. BaFin is currently working on a corresponding circular on the Supervisory Requirements for IT in Insurance Undertakings (*Versicherungsaufsichtliche Anforderungen an die IT – VAIT*)<sup>58</sup>.

### Collective responsibility of all management board members

BaFin's move towards greater flexibility is limited due to the collective responsibility of the management board members and, in the case of credit institutions, the requirements for unanimous decisions – in particular, those approving large exposures and granting loans to board members pursuant to section 13 (2) and section 15 (1) of the Banking Act respectively. Regardless of the allocation of responsibilities, all members of the management board carry overall responsibility for a proper system of governance and are subject to the associated duties of care and statutory provisions on liability. While each member of the management board bears, first and foremost, full responsibility for their respective portfolio, they must nonetheless, in light of their collective responsibility, take action and attempt to find remedies, at the latest as soon as any indications of irregularities in another member's area of responsibility arise (principle of mutual oversight).

### Collective qualifications

As a result of BaFin's change to its administrative practice, the collective qualifications of the management board will become a matter of greater importance. Therefore, BaFin will be paying particular attention to whether the board as a whole is sufficiently qualified while also taking the principle of dual control into consideration. This principle means, specifically, that more than just one management board member must be competent in each of the conventional areas of banking or insurance business, as any other arrangement would not be sufficient to ensure effective mutual oversight. As a result, it is easier to envisage the appointment of a management board member who is only responsible for IT in cases where the board consists of more than three persons who, moreover, have sound knowledge of banking or insurance business.

### Notification requirements

For the assessment of suitability of CIOs, banks must provide a description of the specific position together with the details and documents to be submitted

<sup>57</sup> See 7.2 and chapters I 2 and III 1.4.2.

<sup>58</sup> See chapter I 2.

pursuant to section 24 (1) no. 1 of the Banking Act when notifying BaFin of having made an appointment or their intent to do so. As part of this process, the relevant competencies must be specified and the schedule of responsibilities must be included. In relevant cases, BaFin also intends to impose an additional reporting requirement on credit institutions for changes to the allocation of responsibilities.

## 7.2 IT risks at banks and insurance undertakings

Created by BaFin in 2017, BAIT communicates what BaFin expects of a proper IT organisation in banks in relation to the internal IT systems as well as the IT services the institutions purchase from third parties.<sup>59</sup> BAIT is above all intended to raise the awareness of IT risk throughout the institutions – including with respect to their relationship with IT outsourcing providers.

BaFin is planning to publish the corresponding Supervisory Requirements for IT in Insurance Undertakings and Pension Funds (VAIT) in mid-2018. BaFin carried out an industry survey in the second half of the year 2017 in order to get an initial overview of how insurance undertakings and pension funds handle their exposure to cyber risk. This was aimed at identifying the typical strengths and weaknesses of the undertakings.

The survey was at the same time a way to let the industry know that BaFin considers IT risk, which includes cyber risk, material and will therefore examine this risk at the supervised undertakings even more closely in future.<sup>60</sup>

### **Cloud computing at insurance undertakings**

A key issue that Insurance Supervision has been working on in great detail since 2017 is the use of cloud computing. As with any outsourcing arrangement, the insurance undertaking remains responsible for meeting all supervisory requirements and obligations in such a case. Furthermore, outsourcing must not restrict the undertaking's management and control options or BaFin's review and supervision rights. Banking Supervision is also giving close attention to the issue of cloud computing. Here, the same supervisory requirements apply with regard to outsourcing as is the case with insurance undertakings.

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<sup>59</sup> For details on BAIT, see chapter III 1.4.2.

<sup>60</sup> For details on this survey, see chapter I 2.

## 7.3 Crypto tokens

It has been BaFin's settled administrative practice for six years to classify cryptocurrencies, such as Bitcoin and other crypto tokens, as units of account from a supervisory point of view and therefore as financial instruments pursuant to the Banking Act. One of the consequences is that commercial trading in crypto tokens requires authorisation. In view of the strong price movements again seen in 2017, BaFin has received a large number of enquiries about business models in connection with crypto tokens, for example relating to Bitcoin ATMs. The installation of such ATMs is in all cases an activity subject to authorisation requirements under the Banking Act.

In February 2018, BaFin published another information document, in which it comments on the regulatory classification of tokens in the area of securities supervision. It applies to all market participants that provide services related to tokens, trade in tokens, or offer them to the public.<sup>61</sup> In order to comply fully with any legal requirements, these market participants are required to examine carefully whether they are dealing with a regulated instrument, such as a security or financial instrument pursuant to the Banking Act. If there is any doubt, they should contact BaFin as soon as possible, either using the fintech company contact form or directly via the divisions responsible for the issue in question (see info box "New division focusing on innovations in financial technology" on page 59).

### **BaFin warns about initial coin offerings**

In November 2017, BaFin issued a warning about a whole range of risks associated with initial coin offerings (ICOs), a highly speculative form of corporate and project financing. Although new sources of financing, such as ICOs, are to be welcomed, especially for young, innovative companies, a situation should be avoided where existing regulation, which is in place to deal with risks in the interest of consumer protection and financial market integrity, is bypassed or frustrated.

Against this backdrop, BaFin made investors aware of risks such as the potential loss of all their invested capital, if they buy coins or tokens in an ICO.

The collective term "initial coin offering" refers firstly to the creation of crypto tokens on existing blockchains or blockchains created specifically for this purpose,

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<sup>61</sup> [www.bafin.de/dok/10690958](http://www.bafin.de/dok/10690958).

## Note

## New division focusing on innovations in financial technology

Partly as a response to the digital transformation in the world of finance, BaFin established a new division in 2016<sup>62</sup>, which is intended to identify and assess innovations in financial technology and their impact from the Supervisory Authority's perspective. To this end, this division, SR 3, works as part of an internal network of all departments at BaFin, widely exchanging information and views with external parties, such as scientists, technology experts, innovation hubs and other authorities in Germany and abroad.

and secondly to the associated development of smart contracts and distributed apps, which are stored on existing blockchains in the form of programme codes for the implementation of contracts. New digital units (tokens) are generated in this process, which are then sold to investors in exchange for another virtual currency or legal tender. The issuer decides freely what rights it grants to investors acquiring the respective tokens. The project and the way in which the tokens work are normally presented in a whitepaper; traditional contract terms and conditions are less common.

BaFin decides on a case-by-case basis, looking at the technical and contractual details of an ICO, whether the issuer requires authorisation under supervisory laws and is obliged to publish a prospectus.

Despite having a similar name, ICOs are not comparable to IPOs, which are initial public offerings of companies looking to list. In many cases, the tokens issued confer neither membership nor information, control or voting rights. Nor does the implementation of an ICO require a specific corporate form, or even actual business operations. It has so far been up to the investors themselves to check the identity, integrity and creditworthiness of the token issuer and to understand and assess the investment being offered. ICOs are often highly speculative, because they are typically implemented at a very early, mostly experimental stage of a company, when the business model is still untested. The systemic vulnerability

of ICOs to fraud, money laundering and terrorist financing increases the risk of investors losing the capital invested.

## 7.4 Robo-advice

An increasing number of undertakings are offering financial instruments online. These kinds of securities services are generally subject to the same requirements as services provided through branches or by telephone, for example. This also applies to investment advice and portfolio management.

The automated distribution of financial instruments and similar digital services – also known as robo-advice – generally meet the definition of investment advice and therefore require authorisation under banking or industrial law. If such authorisation has not been granted or if the associated requirements of the German Securities Trading Act (*Wertpapierhandelsgesetz*) or of the German Industrial Code (*Gewerbeordnung*) are not satisfied, the providers expose themselves to a considerable legal risk. Even though many new offers are coming onto the market, it is therefore not worthwhile to launch a robo-advisor for the sake of speed which tries (in vain) to avoid having to fulfil the requirements applicable to investment advice. Instead, the providers should make use of the opportunities offered by new media to provide full investment advice with the authorisation and under the supervision of BaFin and therefore make a contribution towards the creation of a consumer-friendly market environment.

### Character of a personal recommendation

The decisive criterion for determining whether the information provided constitutes investment advice is whether the result generated by the robo-advisor has the character of a personal recommendation, i.e. whether the recommendation reflects the client's personal circumstances. If, on the other hand, the provider informs the client in a neutral manner, this does not constitute a recommendation. This applies for example to the provision of a search function, which selects from an existing product offering purely on the basis of objective product features. Unlike investment advice, portfolio management gives clients more than a one-off investment recommendation; instead their portfolio is managed on an ongoing basis. However, the securities account is kept with a depositary bank, and the asset manager is given power of attorney.

## 7.5 Critical infrastructure

62 See 2016 Annual Report, page 65.

### Operators in the financial sector: identification and requirements

Major attacks on corporate IT systems have laid bare the vulnerability of critical infrastructure (see info box "Critical infrastructure"). As early as 2015 – even before the European Directive on Security of Network and Information Systems (NIS Directive)<sup>63</sup> entered into force – German legislators created corresponding regulations, which they inserted into the German Act on the Federal Office for Information Security (*Gesetz über das Bundesamt für Sicherheit in der Informationstechnik*) by way of the German IT Security Act (*IT-Sicherheitsgesetz*).

In the Regulation Amending the German Regulation on the Identification of Critical Infrastructure (*Änderungsverordnung zur BSI-Kritis-Verordnung*)<sup>64</sup> of 21 June 2017, legislators have specified in greater detail the criteria according to which financial sector companies qualify as operators of critical infrastructure.

Pursuant to sections 8a and 8b of the Act on the Federal Office for Information Security, operators of critical infrastructure therefore have to meet a number of requirements. They have to identify themselves as operators of critical infrastructure by notifying the Federal Office for Information Security of a point of contact within the company that has to be reachable around the clock.

Moreover, they have to demonstrate every two years that they have taken appropriate organisational and technical measures to avoid disruptions to the availability, integrity, authenticity and confidentiality of their information technology systems, components or processes.

The Regulation on the Identification of Critical Infrastructure has identified the following services in the financial sector as critical: cash supply, card-based and conventional payment transactions in the banking sector, clearance and settlement of securities and derivatives transactions as well as the contract management, benefit, claim and payment systems of insurance undertakings.

<sup>63</sup> Directive (EU) 2016/1148, OJ EU L 194/1.

<sup>64</sup> BSI stands for the Federal Office for Information Security (*Bundesamt für Sicherheit in der Informationstechnik*).

#### Definition

### Critical infrastructure

Critical infrastructure within the meaning of the Act on the Federal Office for Information Security comprises facilities, systems or parts thereof belonging to the energy, information technology and telecommunications, transport, health, water, food, finance or insurance sectors and are essential for the functioning of society, because their failure or disruption would lead to considerable supply shortages or risks to public safety and security in Germany.

#### Joint supervision of operators of critical infrastructure in the financial sector

Banks, insurance undertakings, payment institutions and IT services providers qualifying as operators of critical infrastructure are subject to supervision by both the Federal Office for Information Security and BaFin. BaFin and the Federal Office for Information Security try to keep any additional workload that could result from this dual responsibility to a minimum as far as legally possible. The aim is to pool the technical expertise of the Federal Office for Information Security and BaFin's operational supervisory powers to ensure resources are used efficiently.

## 8 International supervision

### 8.1 Review of the European System of Financial Supervision

The European System of Financial Supervision (ESFS; info box on page 61) is currently being reviewed. The aim from the outset was to test how effectively the ESFS, and thus also the European Supervisory Authorities (ESAs) operate, and to reform them if necessary. In March 2017, the European Commission presented a reform proposal for consultation, which led to a draft amendment to the ESA regulations in September. This draft amendment envisages far-reaching centralisation of, and thus a fundamental change to, the EU's existing supervisory architecture.

#### New powers for the ESAs

In order to promote supervisory convergence within the EU, the Commission has proposed that additional tasks

## European System of Financial Supervision

The three European Supervisory Authorities (ESAs) were launched at the beginning of 2011. They comprise the European Banking Authority (EBA), the European Insurance and Occupational Pensions Authority (EIOPA) and the European Securities and Markets Authority (ESMA). Shortly before, at the end of 2010, the

European Systemic Risk Board (ESRB) had started its operation. Together, the ESAs and the ESRB form the European System of Financial Supervision (ESFS), which is aimed at harmonising supervisory practice in Europe and to improve the integration between macro-prudential analysis and micro-prudential supervision.

and powers should be transferred to the ESAs. According to the proposal, they are to set EU-wide strategic supervisory plans in future against which the competent authorities will be assessed. In addition, the Commission is planning to involve the ESAs if undertakings domiciled in the EU plan significant outsourcing to third countries. The ESAs are to be allowed to issue opinions on the authorisation proceedings. The powers of the ESAs are also planned to be expanded for when they assist the European Commission in preparing its third-country equivalence decisions.

For insurance supervision, the Commission is proposing that EIOPA should be involved in a meaningful and timely manner in the approval process as well as in the ongoing supervision of internal models. There are plans to give EIOPA a dual role in this context, i.e. it will firstly be able to issue opinions and secondly provide support in settling disagreements between the supervisory authorities affected.

The most extensive changes proposed relate to ESMA. The plan is firstly to introduce direct supervisory powers over central counterparties (CCPs). To this end, the Commission published a draft amendment<sup>65</sup> to the European Market Infrastructure Regulation (EMIR) in June. Secondly, ESMA is to be given primary responsibility for the approval, supervision (including market and advertisement supervision) and sanctioning of certain types of prospectus. In addition, ESMA will in future be responsible for approving and supervising data reporting service providers as well as for approving, registering and supervising certain funds and their investment managers.

In terms of internal governance of the ESAs, the Commission's proposal advocates a partial departure

from the principle of member-led organisations. The Boards of Supervisors (BoSs), which consist of heads of the national competent authorities, are to remain the principal decision-making bodies of the ESAs, especially for regulation. But an Executive Board is to be introduced in addition, which will replace the existing Management Boards, which, like the Boards of Supervisors, currently consist of heads of the competent authorities. According to the Commission's proposal, the members of the Executive Board will include the ESA Chairperson as well as three ESA representatives each at the EBA and EIOPA and another five at ESMA. Their function will be to prepare all BoS decisions by issuing an opinion. Furthermore, there are plans to transfer key competencies (e.g. for stress tests and the new tasks and powers mentioned earlier) to the Executive Board.

As for financing the ESAs, the European Commission proposes that the contributions of the national competent authorities should be replaced by contributions from private sector entities. The EU's contributions are to be made variable in future, covering up to 40 percent of the ESAs' budget. The European Council is currently debating the European Commission's proposals.

### BaFin critical of the plans

BaFin had been critical of the changes planned by the European Commission already during the consultation phase. The European System of Financial Supervision (see info box "European System of Financial Supervision") was created in 2010 specifically as a network of national and European supervisory authorities and has proven itself in this role.

Of course, BaFin strongly supports of a more active role for the ESAs when it comes to creating supervisory convergence and a shared supervisory culture in the EU. But it is against creating a "supervisor of the supervisor" or granting the ESAs information powers that belong to the national competent authorities. BaFin also

<sup>65</sup> [https://ec.europa.eu/info/law/better-regulation/initiative/30988/attachment/090166e5b2ff17c9\\_en](https://ec.europa.eu/info/law/better-regulation/initiative/30988/attachment/090166e5b2ff17c9_en).

rejects plans to allow the ESAs to intervene in national authorisation proceedings. Moreover, in view of the subsidiarity principle, BaFin has argued from the outset that moderation should be used when transferring new responsibilities to ESMA so that the legal limits are not transgressed. President Felix Hufeld also explained BaFin's position at a hearing before the European Parliament on the review of the European System of Financial Supervision held on 27 February 2018.<sup>66</sup>

## 8.2 Bilateral and multilateral cooperation

BaFin signs memoranda of understanding with other supervisory authorities to encourage cooperation with such organisations (MoUs; see the Appendix on page 201). In 2017, BaFin signed an MoU with the Israel Securities Authority (ISA), which now gives the two authorities a basis for cooperating on securities supervision, and prospectus supervision in particular. BaFin is in the process of negotiating further MoUs.

### Technical cooperation

BaFin and the Deutsche Bundesbank held a joint seminar on the performance of the bond market and the strengthening of the banking system at Cameroon's securities supervisor, the *Commission des Marchés Financiers* (CMF), to name but one example. In the EU Twinning Project for the Republic of Montenegro, BaFin has assumed the project lead. Together with the supervisory authorities of Croatia and the Netherlands as well as the Deutsche Bundesbank, BaFin is providing support to Montenegro in the two-year project aimed at aligning its legislation with the totality of EU law. In addition to steering the project, BaFin's key task involves supporting the country in developing a supervisory system for the insurance and securities sector. The banking sector is covered by the Bundesbank and the Croatian National Bank (*Hrvatska Narodna Banka*).

As a member of the European Supervisor Education Initiative (ESE), BaFin also hosted specialist seminars on the issues of consumer protection and supervisory colleges in 2017.

### Multilateral cooperation

BaFin supports the introduction of the Enhanced Multilateral Memorandum of Understanding (EMMoU) of the International Organization of Securities Commissions (IOSCO) and continued to actively pursue

### Definition

## ACFIT powers

- A (to obtain audit papers): the authority must be allowed to obtain and share audit papers.
- C (to compel testimony): the authority must be able to summon and interview individuals. The individual's physical attendance must be enforceable by way of a coercive fine or imprisonment.
- F (to freeze assets): the authority should be able to seize assets – either itself or through a court.
- I (to obtain internet service provider records): the authority must be able to obtain customer master data and traffic data from internet service providers as well as the contents of these communications from supervised entities.
- T (to obtain telephone records): the authority must be able to obtain customer master data and traffic data from telecommunications companies as well as the contents of these communications from supervised entities.

its implementation in 2017. The core element of the EMMoU is the ACFIT powers (see info box "ACFIT powers"). They comprise rules for obtaining audit work papers, compelling attendance for testimony, advice on freezing assets on behalf of a foreign supervisor, and obtaining and sharing internet service provider and telephone records.

## 9 Risk modelling

### 9.1 Risk models in the banking sector

In 2017, work focused on further enhancing the requirements for the appropriate use of internal models in bank management and regulation.

#### Basel III finalised

The comparability of internal model results across institutions has been a subject of sometimes fierce debate since the financial crisis. After years of intensive consultations, the Basel reform package was finally adopted in December 2017.<sup>67</sup>

<sup>66</sup> The speech delivered by BaFin President Felix Hufeld at the hearing on the review of the European System of Financial Supervision is available in German and English at [www.bafin.de](http://www.bafin.de).

<sup>67</sup> See chapters I 4 and III 1.1.

Internal models will now not be abolished, as had been feared. BaFin and the Bundesbank had campaigned for continuing to allow the use of internal models for many portfolios in order to enable a risk-sensitive approach to calculating capital. From BaFin's point of view, internal models are not an end in themselves, but are instead intended to strengthen an institution's risk management – as well as to ensure that capital is adequately calculated.

The purpose of the revised Basel regulatory framework is to limit unintended excessive variances in capital requirements calculated using internal models. Regrettably, there was not enough differentiation between intended and unintended variability, so that a minimum capital requirement based on the less risk-sensitive standardised approaches was ultimately chosen. For banks using internal models, this output floor (72.5 percent) limits the amount of capital benefit a bank can gain to 27.5 percent, relative to using the standardised approaches.

It remains to be seen how seriously the new rules will impact on the banks' capital requirements as well as on risk control and risk management.

#### **Targeted Review of Internal Models**

The SSM's Targeted Review of Internal Models (TRIM) project continued successfully in 2017. Launched in 2016, this multi-year project aims to ensure that capital requirements are the same for identical risk positions throughout the SSM and to standardise and strengthen the supervision of internal models within the SSM. Through TRIM, BaFin also wants to contribute to rebuilding confidence in the use of models to calculate risk and capital requirements, which has been shaken since the financial crisis.

In 2016, model experts of the national competent authorities and of the ECB formulated "supervisory expectations" for banks and guidelines for model reviewers in respect of areas selected for special attention. Since the beginning of 2017, checks have been conducted in supervisory interviews and reviews to establish whether the main European banks using internal models meet these expectations. To this end, 120 reviews for the credit, market and counterparty risk types were scheduled for 2017 and the first half of 2018; of this number, over 90 had been started by the end of 2017 and over a quarter of them completed. The credit risk reviews focus on model-specific issues for the retail business and small and medium-sized enterprises exposure classes. Reviews relating to selected methodology issues in the institutions, large corporates

and special financing exposure classes are scheduled to start in September 2018.

Simultaneously with these reviews and supervisory visits, the working groups of the project supplemented and refined the supervisory expectations they had developed, taking comments made by the industry into account.<sup>68</sup> The supervisory expectations and guidelines continue to be adjusted in response to experience gathered during the ongoing reviews. There will be consultation with the banks on the final standards towards the end of the project, before they are ultimately adopted by the Supervisory Board of the SSM.

The good, close cooperation between the model experts of the national competent authorities and the ECB in the TRIM project is a significant factor contributing to the very successful progress of the project to date. This cooperation should therefore be strengthened and sustained beyond the end of the TRIM project.

#### **Supervisory benchmarking**

As in the previous year, a supervisory benchmarking exercise of the internal approaches pursuant to Article 78 of the Capital Requirements Regulation (CRR)<sup>69</sup> was conducted in 2017. The supervisory credit risk benchmarking in 2017 focused on portfolios of the "sovereign", "institutions" and "large corporates" exposure classes. Since only relatively few defaults are generally observed in these exposure classes, they are also referred to as low-default portfolios (LDPs).

As expected, the comparison of the banks participating in this process showed a certain level of variability in risk-weighted assets (RWA). However, in most cases this could be attributed to simple reasons, such as differences in the proportion of exposures in default, the portfolio composition and the geographical mix. This variability is desirable, because it is caused by different risks, which are meant to be measured by the risk-sensitive process. Any variability not attributable to these causes is further investigated jointly by the EBA, the national competent authorities (NCAs) and in the SSM. In most cases, the participating banks were able to explain and justify any variances from benchmarks calculated as part of the supervisory benchmarking exercise on the basis of the European sample.

<sup>68</sup> [https://www.bankingsupervision.europa.eu/ecb/pub/pdf/trim\\_guide\\_en.pdf](https://www.bankingsupervision.europa.eu/ecb/pub/pdf/trim_guide_en.pdf).

<sup>69</sup> Regulation (EU) 2013/575, OJ L 167/1.

## 9.2 Negative interest rates in internal models of insurers

Since 2016, the phenomenon of negative interest rates has been causing insurance undertakings to revise their internal models (see info box “Models and negative interest rates”). This primarily affected the valuation model for life insurance policies, where a stochastic valuation is carried out on portfolios by simulating the development in future capital market scenarios, and the risk projection model of the users of internal models, which simulates, among other things, possible interest rates over a one-year development period to calculate the capital requirement of the undertaking.

Because of negative interest rates on the capital markets, the traditional assumption of an interest rate floor of zero is no longer tenable. The modelling of negative interest rates raises questions about factors such as the existence and level of a new, now negative, interest rate floor that can be economically justified, since negative interest rates are regarded as difficult to interpret from an economic perspective, especially in the long term. The “physical cash argument” is often used in this debate: if interest rates go deep into negative territory, undertakings could transfer their money to physical cash, rather than incur massive losses by investing the capital. The cost of

keeping physical cash would therefore determine an interest rate floor.

However, this argument is controversial and was of minor significance in the modification of models. The implicit interest rate floors were instead chosen in accordance with the other requirements on the models, and they are normally below the notional “cost of holding physical cash”. Factors significant for the valuation model are above all market consistency, i.e. the replication of market prices for bonds and interest rate options, as well as no-arbitrage bounds (the model does not generate any risk-free return that exceeds the risk-free interest rate). In the risk model, the one-year forecast horizon is meant to take account of not only empirical experience and existing economic knowledge, but also requirements for appropriate risk management in the insurance undertaking.

BaFin reviewed the model changes required and approved them in 2017. If negative interest rates are adequately modelled and processed, this raises the stability of the model results. The results are a better reflection of the current capital market environment, are easier to interpret from an economic perspective and thereby increase the usefulness of the internal model.

### Definition

#### **Models and negative interest rates**

Short-term and long-term interest rates have been on the decline since 2008, and have even become negative in some cases. By contrast, interest rate models typically conceived before this development started are often based on the assumption of positive interest rates. This means that they are normally no longer suitable and have in the past been unable to adequately reflect the risk profiles of the undertakings. The relevant risk-free yield curve could no longer be replicated in the internal model, and financial guarantees and options in the technical provisions were no longer valued correctly. This meant that internal models were also of limited use in the management of the undertaking.

## 10 Accounting

On 13 July 2017, the EBA published on its website the report on its second impact assessment of the new IFRS 9<sup>70</sup> standard, which has been applicable since 1 January 2018. This study surveyed approximately 50 European institutions about the quantitative and qualitative impact of the new standard.

The EBA comes to the conclusion that the institutions included in the survey have made significant progress in implementing the new standard compared with the first exercise conducted at the beginning of 2016<sup>71</sup>. There was, however, still evidence that, in terms of implementation, small institutions were lagging behind the larger ones.

<sup>70</sup> The abbreviation stands for “International Financial Reporting Standard”. IFRSs are issued by the International Accounting Standards Board (IASB).

<sup>71</sup> See 2016 Annual Report, page 79 f.



Similar to the first round of the survey, the quantitative impact was mainly attributable to the new impairment requirements and less to the new classification and measurement requirements. On average, European institutions expect provisions to increase by 13 percent. The CET1 ratio<sup>72</sup> of the European institutions decreased by an average of up to 45 basis points.

### IFRS 17 “Insurance Contracts”

On 18 May 2017, after several years of consultations, the International Accounting Standards Board (IASB) published IFRS 17 “Insurance Contracts”. The new standard replaces the old interim standard, IFRS 4, which has been applicable since 2004. When it enters into force on 1 January 2021, it is intended to give users of financial statements and investors a better understanding of the risks and profitability of insurers. At the same time, it is intended to make comparisons of different insurers easier. One milestone in this process is the measurement of insurance contracts, which will no longer be made at historical cost, but at fair value, determined on the basis of the discounted best estimate plus a risk margin and a contractual service margin.

By the end of 2018, the European Financial Reporting Advisory Group (EFRAG)<sup>73</sup> will prepare a final proposal for adoption into European law (endorsement). BaFin is closely involved in this process. In addition, it is deeply engaged in analysing the interaction between Solvency II (the supervisory regime already applicable in Europe) and the new IFRS 17. An interesting aspect of this process is the extent to which the two regimes prescribe different treatment for the same issues.

## 11 Environmental and climate risks

In the face of numerous environmental and climate risks, the creation of a low-carbon economy is one of the major challenges facing society. The financial sector is also exposed to environmental and climate risks. In addition, the sector faces transition risks. The financial sector could contribute to a successful transition by

adequately assessing future investment risks and opportunities, thus helping to make capital allocation more efficient.

Given its great economic and social importance, this group of issues is acquiring its own momentum across countries, industries and market players: for example, many market participants are considering adopting the recommendations published in June 2017 by the sector-led Task Force on Climate-related Financial Disclosure (TCFD) established by the Financial Stability Board (FSB). The disclosure of environment-related financial risks outlined there is intended to help market participants to take account of environmental and climate risks systematically in their risk management and investment decisions.

At the same time, various parties representing, among others, the scientific community and non-governmental organisations, are engaged in scenario analysis in order to model the potential impact of climate change on the portfolios of entire industries as well as individual market participants.

On 8 March 2018, the European Commission presented an action plan for sustainable finance<sup>74</sup>, which is based on the recommendations of the EU’s High-Level Expert Group on Sustainable Finance (HLEG) published in January 2018.<sup>75</sup>

Among other things, this action plan is expected to focus on the development of details for the concept of fiduciary responsibility in capital investment decisions in order to create a clear framework for investments in sustainable financial products. This shows that the focus of the international debate is expanding from the previous mainly risk-based consideration of climate risks towards the larger group of issues relating to green/sustainable finance.

BaFin is actively involved in this group of issues: it is working jointly with other supervisory authorities and central banks towards an internationally harmonised regulatory framework, engages in exchanges with relevant players, and emphasises the importance of environmental and climate risks in its own supervisory activities.

<sup>72</sup> CET1 stands for Common Equity Tier 1 capital.

<sup>73</sup> Established in 2001, EFRAG is a non-profit association under Belgian law. Its registered office is in Brussels. Its primary objective is to assist the European Commission in the process of endorsing IFRSs.

<sup>74</sup> [https://ec.europa.eu/info/publications/180308-action-plan-sustainable-growth\\_en](https://ec.europa.eu/info/publications/180308-action-plan-sustainable-growth_en).

<sup>75</sup> The HLEG’s Financial Report was published in January 2018; [https://ec.europa.eu/info/publications/180131-sustainable-finance-report\\_en](https://ec.europa.eu/info/publications/180131-sustainable-finance-report_en).

However, in his New Year speech delivered on 17 January 2018, BaFin's President Felix Hufeld warned against granting regulatory favours, "without fact-based analysis, the assessment of risk profiles, default probabilities, risk-return ratios, et cetera". People who did that, he said, were sowing the seed for a new financial crisis:

"The creation of owner-occupied housing for low-income households in the United States was a legitimate political goal that received praise from all sides in the early 2000s. Only in combination with inadequate and to some extent silent financial regulation did it become, as we all know, a disaster."<sup>76</sup>

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<sup>76</sup> [www.bafin.de/dok/10361936](http://www.bafin.de/dok/10361936) (only available in German).



# III

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



# 1 Bases of supervision

## 1.1 Basel III global framework

**T**he oversight body of the Basel Committee on Banking Supervision, the Group of Governors and Heads of Supervision (GHOS), resolved the finalisation of the Basel III reform package on 7 December 2017. Following intensive and difficult negotiations, agreement was reached on the last outstanding point and the output floor for risk-weighted assets was fixed at 72.5 percent.<sup>1</sup> The purpose of the output floor is to curb the unintentionally large deviations in capital requirements which banks calculate using their internal models. It will be introduced in stages over a period of five years starting on 1 January 2022.

The compromise reached in December 2017 includes many important German positions which have now been incorporated in the Basel regulatory framework. For example, the standardised approaches are significantly

more risk-sensitive and institutions will continue to be able to use internal models for almost all exposure classes. There had been repeated attempts in recent years to discredit internal models completely and eliminate the risk-sensitive approach, explained BaFin President Hufeld, who represented Germany in the GHOS together with Bundesbank President Jens Weidmann. He had always been clear that he would not have agreed to the Basel III compromise if that red line had been crossed. "But we successfully fought off those attempts."<sup>2</sup>

### **Compromise on the limits of acceptability**

BaFin is of the opinion that the increase in capital requirements resulting from the Basel compromise is acceptable for German institutions. "The compromise is probably right on the limits of what BaFin could accept with the result that we were just about able to agree", comments Hufeld. Significant increases can be expected in particular cases. On the other hand, some institutions are likely to see a reduction in capital requirements compared with the present position. This is due to the changes to the standardised approach for credit risk and in relation to operational risk.

<sup>1</sup> See chapter II 10.1.

<sup>2</sup> On BaFin's position, see also chapter I 4.

## 1.2 Banking regulation in the European Union

### 1.2.1 Reform of the CRR and CRD IV

On 23 November 2016, the European Commission initiated a comprehensive revision of the Capital Requirements Regulation (CRR) and the Capital Requirements Directive IV (CRD IV), as well as the Bank Recovery and Resolution Directive (BRRD), by putting forward a package of reform proposals.<sup>3</sup> The work on the BRRD was subsequently defined independently and is being advanced in a separate process.<sup>4</sup>

The reform package for the CRR and CRD IV, which implement Basel III among other things, contains a large number of proposals intended to form the basis for discussions in the European Parliament and Council.<sup>5</sup> The Commission launched its initiative with two principal objectives:

- Firstly, some of the provisions of the Basel regulatory framework have yet to be implemented. These consist of individual requirements in the Basel III package, such as the long-term stable funding ratio and mandatory minimum values for the leverage ratio, but also provisions relating to market and counterparty default risks.
- Secondly, the intention is to benefit from the experience gained in applying the CRR and CRD in practice to consider how their effectiveness can be improved, including, and in particular, with respect to proportionality.

#### Greater proportionality

A central concern of the reform project is to give greater prominence to the proportionality principle in the existing European regulatory framework, while not undermining Europe-wide harmonisation. For example, discussions are focussing on how to prevent regulatory requirements imposing an unjustified burden on small and medium-sized banks. These institutions have to rely on a much smaller administrative function to comply with their regulatory obligations than the large, complex financial undertakings.

#### German approach

The Commission's original draft already contained a number of different proposals on this subject. But in the

view of some participants, they do not go far enough to actually reduce the burden for small and medium-sized institutions in practice. Together with the Federal Ministry of Finance (*Bundesfinanzministerium*) and the Deutsche Bundesbank, BaFin has therefore developed a German approach to proportionality which was presented as a position paper in various forums at European level in June and July 2017.

The paper is based on the assumption that all European banks are classified under one of three categories according to their size, systemic importance and risk profile. Graduated regulatory requirements with different levels of strictness and detail would then apply to those categories. Institutions in the top category, which would include institutions posing a potential systemic risk in addition to the systemically important institutions, would continue to be subject to the full regulatory requirements. Institutions in the middle category could expect selective simplified requirements in some regulatory areas, especially in relation to reporting, disclosure and remuneration. For the small, less complex institutions in the lowest category, more extensive simplifications and exemptions could be introduced or they could perhaps be subject to a separate, simplified supervisory regime.

#### Difficult negotiations

Achieving a consensus at European level on the classification criteria and threshold values for allocating the institutions to categories represents a major challenge. Support from European partners has so far been somewhat hesitant. This is likely to be the result of the multifaceted nature of the banking sector within the EU. The individual member states have completely different priorities in response to the specific features of their respective national banking industries. Some do not even see a need to act with respect to the issue of proportionality. Some are worried that the Single Rulebook will be diluted while yet others stress that even small banks can be responsible for substantial risks. Reaching agreement on a specific approach supported by all participants is therefore unlikely to be a straightforward process.

Selective simplifications for smaller institutions in some regulatory areas could be introduced independently of that process in the ongoing CRR/CRD review. The trilogue is unlikely to begin before the second quarter of 2018, while the conclusion of the negotiations and the subsequent publication of the revised regulations are not expected before the summer of 2019.

<sup>3</sup> See [http://europa.eu/rapid/press-release\\_IP-16-3731\\_en.htm](http://europa.eu/rapid/press-release_IP-16-3731_en.htm).

<sup>4</sup> See chapter V 1.3.

<sup>5</sup> See also chapter I 4.

### Threshold values

In the European legislative process, the proportional application of specific regulations is mainly achieved through the use of threshold values. The planned revision of Article 94 of the CRR in particular is expected to result in significant simplifications for small institutions. Article 94 defines the volume of trading book business above which an institution is classified as a trading book institution and becomes subject to the market risk rules. The proposed threshold is now €50 million instead of the existing €15 million. In addition, a further threshold value is being introduced for medium-sized institutions whose trading book positions are both below the threshold of 10 percent of total assets and have a nominal value of less than €500 million. This threshold value will allow them to use the simplified standardised approach to determine their market risk. This option should enable the majority of German institutions to avoid the high cost of implementing the relatively complex Basel standardised approach.

### Proposal on the net stable funding ratio

Turning to the subject of liquidity regulation, a proposal for a simplified indicator for long-term stable funding (net stable funding ratio – NSFR) has been introduced into the European negotiations. It can be found in the European Parliament’s draft report. The proposal is a response to the aim of restricting excessive maturity transformation by requiring an adequate amount of stable funding of the banking business, but without causing disproportionate expense for the implementation of the reporting system or the preparation and quality control of the data.

The concept of a simplified NSFR attempts to solve this dilemma for small and medium-sized institutions by keeping the prescribed ratio of available to required stable funding, but at the same time significantly reducing the degree of differentiation used in defining the factors for available and required stable funding. While the Basel framework takes a highly granular approach here in order to reduce cliff effects in major international banks’ liquidity risk management functions, the German simplified NSFR approach envisages abolishing separate factors for the maturity band between six months and one year, excluding encumbered assets and combining financial instruments into categories if identical factors have already been allocated to them in the past.

While this would reduce the volume of data by more than 90 percent, the loss of information resulting from these simplifications for institutions with a traditional

business model and few innovative financial products would be acceptable. Moreover, to prevent the indicator being watered down as a result of the greatly simplified calculation, a factor would always be applied to aggregated positions which would result in a higher value for the indicator. This is the only way to ensure that the proposed option for credit institutions to calculate a simplified NSFR is not used for the purposes of regulatory arbitrage.

### 1.2.2 Corporate governance guidelines

BaFin was an active participant in the revision of the guidelines of the European Banking Authority (EBA) on the internal governance of credit institutions.<sup>6</sup> The purpose of the revision process is to harmonise and improve governance systems, processes and mechanisms in institutions across Europe – in conformity with the requirements of CRD IV.

The main focus is on the obligations and responsibilities of the supervisory body and the role of the various committees of that body. Furthermore, the revised guidelines are intended to improve the status of the entity’s risk management function and the flow of information between it and the management body, and to ensure more effective monitoring of the risk management system by the supervisory authorities.

### Management bodies and key functions

Together with the European Securities and Markets Authority (ESMA), the EBA has also published guidelines for the purpose of assessing the suitability of members of management bodies and key function holders in credit institutions. BaFin was also involved in the development of these guidelines. The suitability assessment considers whether the candidates have the knowledge, qualifications and skills necessary to guarantee proper and prudent management of the institution. The guidelines place particular emphasis on the role of the institutions in these assessments. Their objective is to harmonise and improve suitability assessments in the individual financial sectors. They are also intended to ensure that the credit institutions put in place sound governance arrangements in line with the requirements of CRD IV and the Markets in Financial Instruments Directive II (MiFID II).

Both sets of guidelines are planned to come into effect for the national competent authorities and for the consolidated institutions concerned on 30 June 2018.

<sup>6</sup> EBA guidelines EBA/GL/2017/11.

## 1.3 Regulations

### 1.3.1 Amendments to the Remuneration Regulation for Institutions

On 3 August 2017, following a consultation and preparatory phase lasting several months, BaFin promulgated the Regulation Amending the Remuneration Regulation for Institutions (*Verordnung zur Änderung der Institutsvergütungsverordnung*)<sup>7</sup>, prepared jointly with the Deutsche Bundesbank. The amended version, which revises the Remuneration Regulation for Institutions of 2013, came into effect one day after publication.

The amendments have implemented the principal requirements of the EBA guidelines for sound remuneration policies<sup>8</sup> into German law. The guidelines set out the remuneration rules of the European Capital Requirements Directive CRD IV and the Capital Requirements Regulation CRR in detail.

Accordingly, the new Regulation focuses in particular on clearer contouring of the types of remuneration and greater differentiation in the treatment of the different forms of variable remuneration. Other major topics include the detailed specification of the risk adjustment provisions and the new obligation to apply clawback arrangements. These arrangements enable variable remuneration components already paid to be reclaimed. Further new features relate to the use of bail-in-able instruments for the purposes of variable remuneration and the remuneration policy at group level, including the identification and treatment of group risk takers.

### 1.3.2 MaSan Regulation

In August 2017, BaFin published the draft of a regulation on the minimum requirements for recovery plans for institutions and securities firms (*Rechtsverordnung zu den Mindestanforderungen an Sanierungspläne – MaSan Regulation*), and an accompanying guidance notice, for consultation. Background: the German Recovery and Resolution Act (*Sanierungs- und Abwicklungsgesetz*) imposes an obligation on all institutions to prepare a recovery plan. Requirements for the contents of recovery plans can be found in the

Recovery and Resolution Act, in the EBA guidelines and in Commission Delegated Regulation (EU) No 2016/1075.

Section 21a (1) of the Recovery and Resolution Act authorises the Federal Ministry of Finance to set out minimum requirements for the structure of recovery plans in a regulation (MaSan Regulation). The Federal Ministry of Finance has transferred the authorisation to issue a regulation to BaFin, subject to the proviso that the regulation is promulgated in consultation with the Deutsche Bundesbank.

#### Regulation and guidance notice

On 9 August 2017, BaFin published the draft of the MaSan Regulation and the draft of a guidance notice on recovery planning for consultation. BaFin asked for comments on the contents of the MaSan Regulation and on the format of the rules and explanatory notes as a regulation and a guidance notice. The consultation exercise did not result in the need for any material changes to the MaSan Regulation or the guidance notice. Moreover, the German Banking Industry Committee has emphasised that it considers the format of the rules, consisting of a regulation and an explanatory guidance notice, to be appropriate

The content of the MaSan Regulation focuses firstly on recovery plans of institutions posing a potential systemic risk (PSIs, see info box “Systemically important institutions and institutions posing a potential systemic risk” on page 73), which must always comply with the full requirements. Secondly, it sets out simplified requirements for 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 reason for this is that institutions belonging to an institutional protection scheme that do not pose a potential systemic risk can be exempted from the recovery planning requirements. In such cases, the IPS must prepare a recovery plan relating to the institutions exempted. The MaSan Regulation sets out the relevant preconditions for exemption and the requirements for the contents of such recovery plans.

## 1.4 BaFin circulars

### 1.4.1 Amendments to the MaRisk

On 27 October 2017, BaFin published the revised Minimum Requirements for Risk Management in banks (*Mindestanforderungen*

<sup>7</sup> See BaFinJournal February 2017, page 5 (only available in German).

<sup>8</sup> Guidelines on sound remuneration policies under Articles 74(3) and 75(2) of Directive 2013/36/EU and disclosures under Article 450 of Regulation (EU) No 575/2013.



## Systemically important institutions and institutions posing a potential systemic risk

BaFin reviews which institutions should be classified as posing a potential systemic risk (PSIs) at least once a year in consultation with the Deutsche Bundesbank. An institution is considered to pose a potential systemic risk if it is either a “global systemically important institution” (G-SII) or an “other systemically important institution” (O-SII), or if BaFin is unable to stipulate simplified requirements for recovery planning for this institution.

In 2017, BaFin classified a total of 39 institutions as PSIs. This is the same number of institutions as in the previous year. The breakdown of the institutions has changed, however: the 39 institutions classified

as PSIs in 2017 include one G-SII, as before, but 13 O-SIIs (previous year: 14) and 25 institutions for which simplified requirements for recovery planning cannot be stipulated (previous year: 24).

A change was made during the year under review to the methodology for allocating the O-SIIs to the capital buffer classes. On the basis of previous years’ experience, BaFin and the Bundesbank have now introduced defined threshold values for the capital buffer classes relating to the additional Common Equity Tier 1 capital required to be held by O-SIIs. However, this did not result in any changes to the capital buffers for the institutions concerned.

*an das Risikomanagement – MaRisk*).<sup>9</sup> They contain significant amendments relating to data aggregation, risk reporting, risk culture and outsourcing.<sup>10</sup>

### Stricter requirements for data aggregation

BaFin has tightened the requirements for data aggregation in order to ensure that the relevant information reaches the responsible decision-makers quickly. The new AT 4.3.4 module applies only to global and other systemically important institutions. Their IT infrastructures must be capable of aggregating the risk positions comprehensively and accurately and of providing this information to the bank’s reporting systems in a timely manner.

In addition to meeting requirements relating to principles for data management, data quality and the aggregation of risk data applying across institutions and groups, the institutions are required to define responsibilities and establish controls for all steps in the processes. A department that is independent of the organisational units responsible for initiating or concluding business transactions must monitor whether employees are complying with the institution’s internal rules, procedures, methods and processes.

### Risk reporting

BaFin has brought together the existing risk reporting requirements and expanded them to include requirements from BCBS 239 in the new BT 3 module. It is directed to all institutions, although the principle of proportionality of course continues to apply. All institutions must prepare regular risk reports and be in a position to generate risk information at short notice if required. The risk reporting must be comprehensible and meaningful and must not only describe the risk situation but provide an evaluation as well.

### Corporate and risk culture

BaFin has also intensified the regulatory focus on corporate and risk culture. The basis for this is the AT 3 MaRisk module. The module requires management to develop an appropriate risk culture, and to integrate and promote it within the institution. The aim is to create an awareness of risk at all levels of an institution, which shapes the everyday thoughts and actions of all employees.

BaFin requires senior management and also other levels of management to provide a clear definition of the types of conduct that are desirable and those that are undesirable. The key precondition for this is that responsibilities are clearly defined at all levels and that employees are aware of the consequences of any infringements. A code of conduct, as required by AT 5, is a major help.

<sup>9</sup> [www.bafin.de/dok/10149454](http://www.bafin.de/dok/10149454).

<sup>10</sup> See BaFinJournal November 2017, page 19 f. and see BaFin website at [shortlink].

## Outsourcing

The amended MaRisk also set out the detailed requirements for the outsourcing of activities and processes. Risk control and the compliance function, as well as internal audit, should remain within the institutions as far as possible in the future. The complete outsourcing of the control functions and internal audit is now possible only in certain exceptional cases. The MaRisk also make it clear that an institution which outsources activities and processes in control and core banking areas must continue to have the expertise and experience to ensure that the services of the outsourcing provider are monitored effectively. The MaRisk additionally require institutions with extensive outsourcing arrangements to have a central outsourcing management function, able to support the management in controlling and monitoring the risks associated with outsourced activities and processes.

### 1.4.2 BAIT: Supervisory Requirements for IT in Financial Institutions

In November 2017, BaFin published the Supervisory Requirements for IT in Financial Institutions (*Bankaufsichtliche Anforderungen an die IT – BAIT*).<sup>11</sup>

The BAIT now form a central component of BaFin's IT supervision of credit and financial services institutions in Germany. The requirements are addressed to the institutions' senior management.<sup>12</sup>

The aim of the BAIT is to create a comprehensible and flexible framework for the management of IT resources, IT risk and IT security. The BAIT are intended to contribute to raising the awareness of IT risk throughout the institutions and with respect to the outsourcing providers. BaFin has also made clear its expectations for the management and monitoring of the IT operation in the BAIT.

#### Interpretation of supervisory standards

BaFin interprets the statutory requirements of section 25a (1) sentence 3 nos. 4 and 5 of the German Banking Act (*Kreditwesengesetz*) in the BAIT. It sets out in detail what it understands by adequate technical and organisational IT resources, in particular with respect to IT security and an adequate contingency plan.

Since the institutions are continually increasing their purchases of IT services from third parties, the BAIT also

interpret section 25b of the Banking Act. This section governs the outsourcing of activities and processes.

The BAIT address important issues in detail and this is intended to assist the institutions in putting in place a proper business organisation, including with respect to the IT infrastructure and their internal and external dependencies. However, the BAIT should not be regarded as a comprehensive catalogue of requirements. In accordance with module AT 7.2 of the MaRisk referred to above, the banks are still required to observe currently applicable standards when implementing the BAIT.

The principle of dual proportionality also applies in full to the BAIT, as it does to the MaRisk. According to that principle, both the management tools available to a bank and the intensity of supervision should match the risks of the institution.

#### Raising IT risk awareness

A central objective of the BAIT is to raise the awareness of IT risk in the institutions – especially at management levels (see info box "IT risk").

#### IT strategy

The most important requirement with respect to the IT strategy is that the management board regularly addresses the strategic implications of the different aspects of IT for the business strategy.

#### IT governance

The management board is also responsible for the effective implementation of the rules on IT governance within the institution and in dealings with third parties. In particular, it is responsible for ensuring that the IT risk and IT security management functions, the IT operations and the development of applications are adequately staffed. This is important from BaFin's point of view so that the risk of any qualitative or quantitative

#### Definition

### IT risk

BaFin defines IT risk as all risks to the institutions' net assets and results of operations arising from deficiencies relating to IT management and control, the availability, confidentiality, integrity and authenticity of the data, the internal control system of the IT organisation, the IT strategy, IT guidelines and IT aspects of the rules of procedure or the use of information technology.

<sup>11</sup> See BaFinJournal January 2018, page 17 f.

<sup>12</sup> See also chapter I 2.

under-resourcing of these areas can be identified at an early stage and eliminated as swiftly as possible.

### **Information security management**

The management board is responsible for agreeing on an information security policy in the light of the institution's risk situation and publishing the policy internally. The protection requirements defined as part of the information risk management system should be specified in detail in the form of information security guidelines. The information security officer has central responsibility for maintaining and monitoring information security within the institution and with regard to third parties. This function must be established on an independent basis with respect to the organisation and business processes.

### **Further development of the BAIT**

The modular structure of the BAIT allows BaFin to make changes or additions if they become necessary in the light of new international or national requirements. Currently, for example, BaFin is considering what additions to the BAIT are required to implement in full the "Fundamental Elements of Cybersecurity for the Financial Sector" published by the G-7 nations in October 2016.

## **1.4.3 Circular on interest rate risk**

BaFin has revised its Circular 11/2011 (BA) on interest rate risk in the banking book of 2011 and published the proposed amended version for consultation in the fourth quarter of 2017. The purpose of the revision was to transpose the EBA guidelines on the management of interest rate risk dated May 2015 into German administrative practice, to the extent that this had not already been implemented with the publication of the Minimum Requirements for Risk Management (MaRisk) dated 27 October 2017 (section BTR 2.3). The German Banking Industry Committee has submitted wide-ranging comments on the Circular and put forward a number of suggested changes, including in particular changes designed to avoid double reporting. At the time of going to press, it was not yet clear whether these changes to the Circular can be made without compromising the implementation of the EBA guidelines.

The principal changes are the inclusion of negative interest, the removal of the alternative procedure for banks unable to measure interest rate risk in present value terms, the inclusion of direct pension obligations and currency aggregation as well as the option of presenting margins in accordance with internal

procedures. In future, the institutions will be able to use cash flows excluding margins for the purpose of calculating interest rate risk, i.e. based on the internal rate of interest or the money and capital market rate of interest for the corresponding maturities. This is subject to the condition that they reflect the risk resulting from margins in their internal risk management procedures, for example in the management of business risk.

The permitted option of an alternative procedure enabling banks unable to measure interest rate risk in present value terms to calculate an approximation of their risk is no longer necessary, since the new MaRisk require the institutions to measure their interest rate risk in present value terms as well as from an earnings point of view. In future, therefore, banks will have to take both risk management perspectives into account.

### **Basel rules not pre-empted**

The planned amendments to the Circular on interest rate risk are not intended to pre-empt the future Basel rules on the measurement and management of interest rate risk in the banking book, since these have not yet been codified at European level. It is therefore limited as before in particular to the requirements for calculating the effects of a parallel shift of 200 basis points upwards and downwards in the yield curve. The rules for the remaining four present value Basel shock scenarios have not yet been finalised. Apart from that, it is BaFin's intention in implementing the current EBA guidelines to anticipate foreseeable changes in the European legislative process in some respects, in order to keep down the renewed costs of transition for the institutions.

BaFin has responded to the comments submitted during the consultation process by making individual changes to the draft. As a result of these changes, among other things, double reporting by the systemically important institutions to the European Central Bank (ECB) and the national supervisory authorities is avoided and definitions are clarified, for example, with respect to the pension obligations to be included as well as supervisory measures in response to particular threshold values for the level of interest rate risk.

## **1.5 Guidelines**

### **1.5.1 Internal capital adequacy approach**

In the second quarter of 2018, BaFin will publish its fundamentally revised guidelines for the assessment of banks' internal capital adequacy approaches. Since the publication of the existing guidelines in December 2011, there have been significant changes in the structure and

practice of European supervision as a result of the Single Supervisory Mechanism (SSM) and the new duties and responsibilities of the ECB, as well as the EBA's guidelines on the supervisory review and evaluation process (SREP). These changes have also had a major effect on the Internal Capital Adequacy Assessment Process (ICAAP).

### **Focus on LSIs**

The revised guidelines take appropriate account of the circumstances and assessment criteria within the SSM. They are aimed solely at the less significant institutions (LSIs) in Germany, which are subject to direct supervision by BaFin. The content of the guidelines is based on the ECB's expectations for significant institutions (SIs) which will be used as a future benchmark for less significant institutions. The guidelines comply with the principle of proportionality as far as the detailed structure of the ICAAP for LSIs and their supervisory assessment are concerned.

The new guidelines prepare the way for the procedure developed by the ECB for the assessment of ICAAPs within the SSM. However, it will still be permitted to continue with the existing ICAAP approach until further notice, if it means that those elements of risk coverage potential that are necessary to comply with the mandatory regulatory capital requirements (including the SREP add-on) are not reflected in the internal capital adequacy approaches (old-style going concern approaches). The relevant requirements that previously formed part of the old guidelines can now be found in the annex to the new guidelines.

## **2 Supervision in practice**

### **2.1 SREP capital requirements in Germany**

In 2016, BaFin began the national implementation of the EBA's guidelines on common procedures and methodologies for the supervisory review and evaluation process (SREP). In collaboration with the Deutsche Bundesbank, an individual overall capital requirement was set for 303 of the LSIs, the less significant German institutions, in the same year as the outcome of the SREP.<sup>13</sup>

BaFin's general administrative act dated 23 December 2016, the order on capital requirements for interest

rate risk in the banking book, applied initially to the approximately 1,200 remaining LSIs for which BaFin had not set an individual overall capital requirement in 2016 as part of the SREP. These institutions were also brought into the SREP capital determination process during 2017. Now that the respective SREP overall capital requirement for individual institutions has become effective, the capital add-on under the general administrative act no longer applies.

### **Pillar 1 plus approach**

The appropriate overall capital requirement for the specific institution is determined in the context of the national implementation of the SREP capital determination using a Pillar 1 plus approach. In addition to the risks already covered by Pillar 1, this includes all other material risks of the particular institution, which are generally quantified by analysing the institution's internal risk measurement and management procedures. The results of the institution's internal procedures for ensuring capital adequacy (internal capital adequacy approaches; ICAAP) therefore play a particularly important role. This ensures that the pronounced heterogeneity of the German banking sector is properly reflected and that the principle of proportionality is observed.

### **Individual determination of the SREP overall capital requirement**

For the purposes of the SREP capital requirement (see Figure 1 "2017 SREP overall capital requirement" on page 77), BaFin determines the capital adequacy for each individual institution pursuant to section 10 (3) of the German Banking Act (*Kreditwesengesetz*). In addition to the existing capital requirement resulting from Pillar 1, which amounts to eight percent of the total risk exposure amount and represents the minimum requirement, a mandatory Pillar 2 add-on is calculated for the particular institution. This represents the total of the capital amounts required to be held for the individual types of risk under Pillar 2. The add-on must comply with the same requirements relating to the quality and composition of capital as apply to the Pillar 1 capital requirements. This means that at least the same proportion of the add-on must be held in the form of Tier 1 capital and/or common equity Tier 1 capital. Moreover, any shortfall will attract the same regulatory consequences for the institution as previously applied for a shortfall in the Pillar 1 requirements.

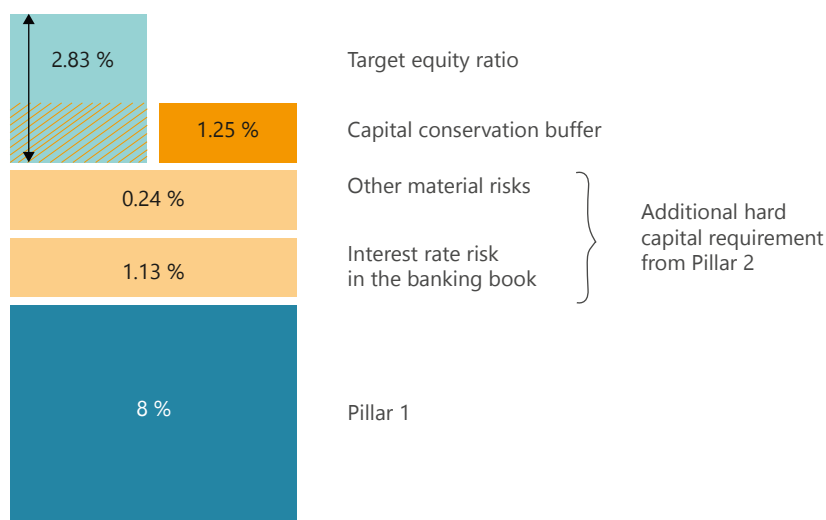
### **Interest rate risk in the banking book**

The most significant risk for which BaFin had to order a capital add-on for specific institutions in 2017 was interest rate risk in the banking book. In order to

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<sup>13</sup> See 2016 Annual Report, page 94.

**Figure 1: 2017 SREP overall capital requirement, as at 31 December 2017**



quantify the risk, BaFin uses the results of a stress test known as the Basel interest rate shock. The results are determined on the basis of standardised scenarios and the institutions’ internal methods and procedures. The SREP capital determinations in 2017 showed that the institutions had to maintain most of their additional own funds to cover interest rate risks principally caused by maturity transformation. The 902 notices issued up to 31 December 2017 showed an average unweighted capital add-on of around 1.13 percentage points for interest rate risks (previous year’s average of the final notices: 0.89 percentage points).

According to the notices issued up to 31 December 2017, the capital requirements for all other risks – in addition to the Pillar 1 risks and interest rate risks – were lower than the average value for the smaller comparable group in the previous year with an average add-on of 0.24 percentage points (average of 2016 notices: 0.59 percentage points).

**Target equity ratio**

In parallel to the SREP overall capital determination, BaFin informs the institutions of their target equity ratio. This is the second component of the Pillar 2 requirements and plays a similar role to the capital conservation buffer required to be maintained in addition to the SREP overall capital requirement. The target equity ratio tells an institution how much additional capital it should maintain from a supervisory point of view, in order to ensure that it is able to comply with the SREP overall capital requirement at all times over the long term and after taking into account potential losses in stress phases.

BaFin derives the target equity ratio from the supervisory stress test, which uses the stress components in the 2017 survey on the low interest rate environment.<sup>14</sup> This target equity ratio can be offset against the capital conservation buffer of 1.25 percent required to be maintained pursuant to section 10c of the Banking Act (2018: 1.875 percent; 2019: 2.50 percent). A positive net target equity ratio, i.e. an amount of capital in excess of the capital conservation buffer, therefore only arises if the supervisory stress test produces a higher value than the capital conservation buffer. However, a target equity ratio which is lower than the capital conservation buffer does not result in a lower buffer requirement, since the capital conservation buffer is prescribed by law. Both regulatory capital under Article 92 of the CRR and free reserves under section 340f of the German Commercial Code (*Handelsgesetzbuch* – HGB) can be used to satisfy the net target equity ratio.

**Supervisory expectations**

In contrast to the SREP capital add-on, the target equity ratio does not represent a strict supervisory requirement but rather an expectation on the part of BaFin. If the target equity ratio is not reached, BaFin reserves the right to step up its supervision, but there is no automatic mechanism for taking supervisory measures. Based on all of the letters sent out up to 31 December 2017, the average target equity ratio amounts to 2.83 percentage points, from which the applicable capital conservation buffer has yet to be deducted. Provided that the capital

<sup>14</sup> See 2.2.1 and chapter I 7.



**Table 7: Methodological rules and interest rate scenarios (2017 to 2021)**

	<b>Scenario</b>	<b>Yield curve</b>	<b>Balance sheet assumption</b>
1	Target scenario	Institution-specific assumptions	dynamic
2	Constant	+/-0 bp* as at 31.12.2016	static
3	Positive interest rate shock	+200 bp as at 31.12.2016	static
4	Negative interest rate shock	-100 bp as at 31.12.2016	static
5	Negative interest rate shock	-100 bp as at 31.12.2016	dynamic
6	Inverse turn	+200 bp to -60 bp as at 31.12.2016	static

\*bp = basis points

conservation buffer is higher than the target equity ratio, the target equity ratio is set at zero.

The 2017 SREP overall capital requirement plus the target equity ratio for the German LSIs therefore amounted to an average of 12.2 percent as at 31 December 2017 (see Figure 1 “2017 SREP overall capital requirement” on page 77). The initial findings indicate that overall the institutions have sufficient capital resources to cover both the strict capital requirements and the additional capital in accordance with the target equity ratio.

## 2.2 Low interest rate environment

### 2.2.1 Stress test

The low interest rate environment continues to weigh heavily on small and medium-sized credit institutions in Germany.<sup>15</sup> This was established by the latest survey on the profitability and resilience of German credit institutions in a low interest rate environment, which was undertaken by BaFin and the Deutsche Bundesbank at the beginning of April 2017.<sup>16</sup>

The survey focused on the around 1,500 small and medium-sized German credit institutions that are directly supervised by BaFin. These account for almost 90 percent of all credit institutions in Germany, corresponding to over 40 percent of total assets.

<sup>15</sup> This section is based on a joint press release by BaFin and the Deutsche Bundesbank dated 30 August 2017, which is available at [www.bafin.de](http://www.bafin.de). For information on the survey on the low interest rate environment, see also BaFinJournal September 2017, page 21 f (only available in German).

<sup>16</sup> See also chapter I 7.

### Profitability

The survey first collected institution-specific target and forecast data. In addition, the credit institutions simulated their earnings for the period 2017 to 2021 in five interest rate scenarios predefined by BaFin, assuming different balance sheet adjustments.

On the basis of their own target and forecast data, the surveyed credit institutions reported that their profit for the financial year before tax would fall by 9 percent over the next five years. Since the institutions simultaneously anticipated balance sheet growth, this corresponds to a 16 percent decline in their total return on capital. In the 2015 survey, banks and saving banks had anticipated a decrease of 25 percent, spread across the following five years.

### Majority well capitalised

The majority of German institutions are well capitalised. “The good level of capitalisation demonstrated by most institutions is useful in softening the effects stemming from the low interest rate environment”, said Raimund Röseler, BaFin’s Chief Executive Director of Banking Supervision, at the presentation of the survey results at the end of August 2017. In addition, most institutions were planning to increasingly focus on alternative sources of income to make up for the dwindling margins in the interest rate business.

The five simulated scenarios point to ever diminishing profitability on the part of German banks and savings banks if the current low interest rate environment persists or intensifies. Banks’ total return on capital would contract by around 40 percent if interest rates remain stable up until 2021, or even shrink by much more than 50 percent if interest rates fall. Assuming a dynamic balance sheet, portfolio adjustments can cushion this impact accordingly, largely on account of contracting

margins in borrowing and deposit business. If interest rates were to be raised, the institutions would initially experience a slump in profits owing to impairments. In the medium to long term, profits would, however, bounce back above their 2016 level on the back of widening margins.

### Resilience

Overall, the institutions concerned intend to increase their Common Equity Tier 1 (CET1) ratio from a level of 15.9 percent to 16.5 percent by 2021. However, one-third of them expect to see a drop in their CET1 ratio over the next five years, mainly as a consequence of the substantial increase in risk-weighted assets that, aside from an upturn in the volume of business, may have been generated by a greater willingness on their part to engage in risky investments.

The institutions continue to expect fierce competition from other banks and fintech companies. Close to every tenth institution indicated that it was currently in the process of implementing a merger or planning to do so in the future.

### Stress test

In order to gauge the impact of a deterioration in economic conditions on institutions' capital adequacy, the survey again incorporated a stress test, used to measure the resilience of credit institutions in the current situation in a variety of stress scenarios covering interest rate risk, credit risk and market price risk. The aim was to establish how effective the credit institutions' capital adequacy was in coping with these stress factors.

### Generally resilient

The test found that most small and medium-sized institutions exhibit a good level of resilience. The Common Equity Tier 1 ratio after stress stands at 13.3 percent across all participating banks. Valuation effects arising from an abrupt interest rate hike have the greatest impact on the stress test. As regards market price risk, the stress effects can be attributed in more or less equal measure to interest-bearing and non-interest-bearing items. However, non-interest-bearing items make up only about one-fifth of the banks' portfolios and are therefore play a disproportionately strong role with respect to stress effects. Turning to the findings of the credit risk stress test, the banks showed themselves to be well equipped to deal with a sudden surge in credit risk. In this connection, the positive macroeconomic developments in particular helped to relieve the situation.

The findings of the stress tests will be fed into the target equity ratio, as described above. This is intended to ensure that the institutions are well capitalised to withstand stress scenarios.

### Financing of residential real estate purchases

The risks of housing loans have increased slightly, but for the most part, lending standards and conditions have not been loosened. A specific stress test relating to the institutions' activities in the area of residential real estate showed that the majority of institutions would be able to cope with an assumed decrease of 20 or 30 percent in house prices over a period of three years. The banks' Common Equity Tier 1 ratios would decline by 0.5 or 0.9 percentage points, respectively.

### Bausparkassen

While the survey was underway, a parallel survey of German *Bausparkassen* was conducted, tailored to their business model. The prevailing low interest rate environment may impinge on the profitability of *Bausparkassen* but the scenario calculations show that their profits should stabilise over time so long as interest rates remain low or incline upwards. If, however, market interest rate levels continue to fall, profits would remain subject to pressure.

The 2017 survey, the third after 2013 and 2015, allows the German supervisors to gain a comprehensive insight into the profit outlook of German credit institutions, identify potential risks at an early stage and heed the findings of the survey in the course of their supervisory activities.

## 2.2.2 Pension obligations

One of BaFin's supervisory priorities in 2017 was an investigation of the risks associated with pension obligations. Accordingly, the 1,500 small and medium-sized German credit institutions directly under national supervision were asked about their direct and indirect pension obligations as part of the 2017 survey on the low interest rate environment. They were also requested to indicate how they dealt with pension obligations in their risk management as at 31 December 2016.

The evaluation of the survey provided BaFin with information on the extent of the direct and indirect pension obligations, and on the allocation of the indirect pension obligations to external pension providers. It also enabled the materiality of pension obligations for the institutions to be estimated and general statements to be made about their riskiness. BaFin will make use of the findings in supervisory interviews with individual

institutions about the economic valuation of pension obligations and in analyses of the institutions' internal capital adequacy.

The results show that for the majority of institutions, their direct pension obligations do not represent a material (balance sheet) item. For some institutions, however, the extent of the obligations exceeded 20 percent of reported equity, with the result that in these cases pension risks could have a significant impact on equity or the risk coverage potential.

#### **Further burden on results of operations**

The treatment of indirect pension obligations in the financial statements is likely to represent a further burden on institutions' results of operations which are already under pressure, as a result of the additions to pension provisions that will be required. The HGB<sup>17</sup> technical accounting rate of interest, which is smoothed over a period of 10 years, will approach the low level of interest rates in stages, so that the consequences of the low interest rate environment will be manifest in rising expenses for pension provisions.

With respect to the allocation of indirect pension obligations to external pension providers, the survey clearly showed that the savings bank sector uses supplementary benefit funds (*Zusatzversorgungskassen*) almost exclusively, while other groups of institutions have not settled on a single type of pension provider.

BaFin's assessment of the risks arising from indirect pension obligations in the event that the retirement commitments given are not fulfilled, or fulfilled only in part, by the pension provider, had not been completed at the time of going to press since the survey did not provide sufficient information for this purpose. However, the overall risk of an institution facing significant funding costs due to unexpected increases in contributions as a consequence of indirect pension commitments entered into, can be assessed as low. Funding gaps for the retirement benefits granted are generally reflected in staged increases in contributions by the pension providers or supplementary payments by the institutions – recognised in the income statement over a period of time.

BaFin will give further consideration to how long-term funding costs arising from indirect pension obligations should be reflected as hidden liabilities in an analysis of internal capital adequacy.

Some institutions have established separate risk control and management processes for risks arising from direct and indirect pension obligations. The reason the majority of institutions have not done so is likely to be because they do not classify the pension risks as material. The reasons for this will be reviewed in individual cases in supervisory discussions with the particular institution.

### **2.3 Recovery and resolution plans: BaFin's experience**

During the year under review, BaFin evaluated more than 30 individual and group recovery plans (see info box "Results of the 2017 benchmark comparison" on page 81), mainly of significant institutions (SIs) from Germany, but also of institutions from other member states of the SSM and less significant German institutions (LSIs). This involves BaFin checking, among other things, whether the plans comply with the regulatory requirements and whether they meet the objective of recovery planning, which is to further improve the institutions' resilience so that they are better able to overcome possible difficulties from their own resources.

A primary component of a recovery plan is therefore represented by the possible courses of action 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 identify crises in good time so that they can initiate appropriate recovery measures. In addition, they must perform stress analyses based both on serious idiosyncratic stress scenarios and on those affecting the market as a whole, and which cover both sudden developments and those arising over a longer period of time.

In addition, in its role as the national competent authority and because of the statutory duties of cooperation, BaFin is consulted by the competent resolution authority on the resolution plans of specific institutions, both via the SSM and via the resolution colleges forming part of the Single Resolution Mechanism (SRM).

The plans come into effect in the event that an institution cannot overcome its financial difficulties on its own and therefore has to be resolved. BaFin gave its opinion from a supervisory point of view on more than 15 resolution plans of German and foreign SIs and LSIs during the year under review. It also reviewed the results of the evaluation of a large number

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<sup>17</sup> German Commercial Code (*Handelsgesetzbuch*).



## Results of the 2017 benchmark comparison

As in previous years, BaFin carried out a benchmark comparison of the recovery plans submitted in 2017 as well. The primary focus of the benchmark comparison was on the core elements of a recovery plan, the possible courses of action, the indicators and the stress scenarios.

The benchmark comparison shows that the possible courses of action fell mainly under the headings “risk reduction”, “capital increase”, “disposals” (of investments and assets) and “access to high-volume funding”. On average, the institutions had around 20 possible courses of action open to them. The institutions rated the viability of around half of their possible courses of action as “high”.

The benchmark comparison also showed that the recovery indicators used in the recovery plans did

not yet comply fully with the requirements of the EBA guidelines on the minimum list of qualitative and quantitative recovery plan indicators<sup>20</sup>. The most frequently used indicators included – as in previous years – the Tier 1 capital ratio, the total capital ratio and the liquidity coverage ratio. Indicators from the EBA minimum list that were used only in isolated cases or not at all were the return on assets, the stock price variation, the cost of wholesale funding, the coverage ratio and credit default swaps of sovereigns.

The benchmark comparison of the events triggering stress scenarios showed that the institutions are not so much testing individual events in the scenarios, but rather combinations or sequences of several events. At the same time, the stress scenarios are most frequently based on the risk of a new financial crisis.

of additional resolution plans of SIs in preparation for meetings of the Supervisory Board of the ECB. Furthermore, BaFin is currently represented in more than 20 supervisory colleges in its capacity as the supervisory authority for the German deposit protection system.<sup>18</sup>

Moreover, BaFin has also been the national resolution authority (NRA) since 1 January 2018, and as such part of the SRM. The NRA prepares resolution plans for institutions and assesses their resolvability. For larger institutions, this is carried out jointly with the SRM. If it becomes clear that an institution is running into difficulties, the NRA prepares resolution actions and, if necessary, implements them. From 2015 to 2017, the Financial Market Stabilisation Agency (FMSA) acted as the NRA.<sup>19</sup>

## 2.4 Supervision of compliance with rules of conduct

### 2.4.1 Survey on cum/cum transactions

On 17 July 2017, the Federal Ministry of Finance published a letter dealing with the tax treatment of “cum/cum” transactions (see info box “Federal

Ministry of Finance on the tax treatment of cum/cum transactions” on page 82).<sup>21</sup>

The responsible tax authorities may order institutions involved in cum/cum transactions to make additional payments of tax on the basis of the Federal Ministry of Finance’s letter. In order to determine the potential effects on German credit institutions and securities trading banks, BaFin and the Deutsche Bundesbank launched a survey on 18 July 2017 on the possible impact of cum/cum transactions on those undertakings. The survey also covered significant institutions subject to supervision by the ECB.

BaFin was concerned in particular to obtain an understanding of the consequences that would arise for the banks’ solvency and whether bank supervisory measures could become necessary. BaFin and the Deutsche Bundesbank did not carry out any investigations into questions of tax law; such investigations do not fall within their remit. The questionnaires designed for the survey were sent out to more than 1,600 institutions and groups of institutions via the Deutsche Bundesbank’s regional offices. The final date for submitting the replies was 20 October 2017.

<sup>18</sup> As at 31 December 2017.

<sup>19</sup> See chapter VI 3.

<sup>20</sup> EBA/GL/2015/02.

<sup>21</sup> The letter on the tax treatment of cum/cum transactions is available at [www.bundesfinanzministerium.de](http://www.bundesfinanzministerium.de).

## Federal Ministry of Finance on the tax treatment of cum/cum transactions

According to the Federal Ministry of Finance's letter, the tax authorities can take up cases during the period prior to the amendment of section 36a of the German Income Tax Act (*Einkommensteuergesetz*), i. e. up to 31 December 2015, in which domestic shares were transferred to a tax resident entitled to a tax credit for investment income tax immediately prior to the dividend record date for the purpose of avoiding a definitive charge to the tax (especially in the case of tax non-residents) (cum/cum structures). If there is no reasonable economic justification for the transaction and overall the case has the features of a tax-motivated structure (tax arbitrage), an abusive

structure within the meaning of section 42 of the German Tax Code (*Abgabenordnung*) can be assumed, according to the Federal Ministry of Finance's letter. The legal consequence is that the tax resident entitled to a tax credit for investment income tax does not receive such a credit for the portion of the investment income tax attributable to the tax-led structure. Following the publication of the letter, the federal states' tax authorities may take up and investigate cum/cum transactions executed up to 31 December 2015, prior to the change in the law, across the board and in accordance with standard criteria.

The survey showed that some of the credit institutions surveyed were involved in cum/cum transactions. According to the information provided by the banks, the financial costs resulting from these transactions have not led in any severe solvency risks which could endanger their existence. At the date of the survey, some of the institutions had already recognised the necessary provisions or had made additional payments of tax. Moreover, the majority of the institutions involved indicated that they intend to use future income to make up for any costs. The replies from the asset management companies which were also asked about possible tax repayment claims in the light of corresponding hedging and securities lending transactions also proved negative for the most part. Only in a few cases are more detailed enquiries necessary. In addition, the investigations by the responsible tax authorities should be borne in mind as they may also result in new findings.

### 2.4.2 Cum/ex

On 21 June 2017, the 4th parliamentary committee of inquiry of the 18th Bundestag submitted its closing report on the group of issues relating to cum/ex transactions.<sup>22</sup> The committee reached the conclusion that BaFin had acted responsibly within its area of competence and had not failed to take action in any reprehensible way. It also made it clear that monitoring compliance with the provisions of supervisory law was a core responsibility of banking supervision, but not compliance with other areas of law such as employment,

social security or tax law. On this point, the closing report was worded as follows: "The Committee stresses that the Banking Act did not provide a legal basis for BaFin to examine individual cases concerned with tax law".

The committee of inquiry also addressed the question of whether BaFin had correctly handled information on breaches of tax law it had become aware of in the course of its audit activities. On this point as well, the committee was not able to identify any breaches of the obligations on BaFin's part and stated: "The conclusion from the evidence gathered is that BaFin acted fully in accordance with the applicable laws".

An amendment to section 9 (5) of the Banking Act, details of which have already appeared in BaFin's 2016 Annual Report, has applied to BaFin's obligations to provide information to other authorities since 6 November 2015.<sup>23</sup> The effect of this amendment is to rescind, to the extent permitted by European Union law, a special provision which had restricted BaFin's obligations to provide information to the tax authorities.

In the course of its duties in 2017, BaFin again assessed the findings from tax-related criminal proceedings and the possible impact of payments of additional tax or tax penalties on the solvency and liquidity position of the banks. Since the amendment to section 9 (5) of the Banking Act, BaFin has also exchanged information with the tax and law enforcement authorities for the purposes of assisting them in their work.

<sup>22</sup> Bundestag printed paper 18/12700 dated 20 June 2017. See also 2016 BaFin Annual Report, page 100.

<sup>23</sup> See 2016 Annual Report, page 100.

## 2.4.3 Panama Papers

In 2016, BaFin required 15 institutions to provide information about business in Panama. 11 of the institutions questioned were unable to exclude the possibility that they had business relationships there, with the result that BaFin investigated these institutions more closely. BaFin asked European authorities for information on these institutions by submitting requests for administrative assistance.

As a result, BaFin received an extensive quantity of data by April 2017. An external firm of auditors examined the data from April to August 2017 for violations of anti-money laundering legislation. 991 cases were audited on a sample basis out of a total of 4,942 cases after adjusting, among other things, for multiple references.

### No material violations detected

BaFin evaluated the results of the investigation. However, it was unable to identify any material violations of anti-money laundering provisions by the institutions; the institutions have largely complied with the applicable anti-money laundering requirements. The models and structures discovered in the course of the investigation are permitted globally in accordance with the German legal position. This also applies to transactions with shell companies which a number of institutions continue to conduct.

#### Note

### Supervision in the SSM

With the launch of the Single Supervisory Mechanism (SSM) in November 2014, the European Central Bank (ECB) took over the direct supervision of those banking groups classified as significant. Joint supervisory teams (JST) are responsible for each of these significant institutions (SIs). Employees of BaFin and the Bundesbank are represented in these teams alongside 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. Each of the JSTs is headed up by one of the ECB's JST coordinators. The core JST for German SIs consists of the JST coordinator together with one sub-coordinator from each of BaFin and the Bundesbank.

## 2.5 German institutions directly supervised by the SSM

### 2.5.1 Work in the joint supervisory teams

BaFin forms part of the European Single Supervisory Mechanism (SSM) in which it plays a central role – among other things, through its participation in the joint supervisory teams – JSTs, (see info box “Supervision in the SSM”). Participants from different countries work together in the JSTs on a firm foundation of mutual trust. In the third year since the beginning of the SSM on 4 November 2014, many processes have become well established. With its experience as an integrated supervisory authority over many years, BaFin is an important initiator for the development and implementation of supervisory strategies for specific institutions. In addition, BaFin President Felix Hufeld is a member of the central decision-making body of the SSM, the Supervisory Board of the ECB.

### End of 2017: 19 German groups of institutions under ECB supervision

Around 100 BaFin banking supervision employees in the internationally staffed JSTs are monitoring the current 19 German SI groups (see Table 32 “German institutions supervised by the ECB under the SSM”, Appendix on page 181)<sup>24</sup> and foreign SIs with a strong presence in Germany. They also carry out the supervisory review and evaluation process (SREP) which is important from a supervisory point of view. In the SREP, the JST assesses the risks of the individual bank and consolidates the findings in an overall rating.

The BaFin employees' responsibilities encompass the whole spectrum of the JSTs' supervisory activities, including thematic reviews and deep dives which shed more light on specific banks' risks, as well as ordering and following up supervisory audits. BaFin colleagues from the policy issues divisions and specialists in modelling, recovery and restructuring provide significant support to the supervisory process. BaFin's representatives are expert and sought-after contacts for the banks in all supervisory matters. In 2017, BaFin's employees participated in over 1,200 discussions and 84 thematic reviews alone and were involved in the SREP decisions of all the SIs supervised.

<sup>24</sup> The groups of institutions (SI groups) are presented here. The individual significant institutions (SIs) are listed in Table 32 in the Appendix, page 181.

## 2.5.2 Assistance in thematic reviews

In 2017, the JSTs evaluated the readiness of the significant institutions for the introduction of IFRS<sup>25</sup> 9 on accounting for financial instruments. Application of IFRS 9 has been mandatory since 1 January 2018. The main feature of the standard is a change in the impairment model from recognising losses that have already occurred to recognising expected losses.

One of the SSM's supervisory priorities in 2017 consisted of conducting a thematic view on the preparation of the institutions for IFRS 9. The review covered over 100 significant institutions applying IFRSs. The objectives of the benchmark comparison were to assess the preparation for the introduction of IFRS 9, to estimate its qualitative and quantitative impact on the recognition of impairment losses in practice and to improve the quality of implementation of IFRS 9. The benchmark comparison started in December 2016 with the development of supervisory expectations for the implementation of IFRS 9 and an assessment methodology.

### Supervisory expectations

The supervisory expectations were based on the published expectations of the Basel Committee and of the EBA as well as on the initial experience of implementation in the banking sector. In the first quarter of 2017, the JSTs collected data, information and documents from the institutions and subsequently discussed outstanding questions directly with the institutions. The quantitative data query was coordinated with an EBA query running in parallel. On the basis of the information obtained, the JSTs rated the institutions' state of preparedness for IFRS 9 in nine categories. The ECB carried out a horizontal analysis in the second quarter of 2017 for the purposes of quality control and to enable a benchmark comparison to be made. The JSTs discussed the findings of the thematic review in further consultations with the individual institutions in June and July 2017. Following on from that, the JSTs informed the institutions in writing of the conclusions reached and recommended measures to be taken. They also incorporated the results of the investigations in the SREP of the relevant institution. In 2018, the JSTs will follow up the institutions' responses to the conclusions and measures recommended on the implementation of IFRS 9. The ECB published a report on the summarised results of the thematic review on the implementation of IFRS 9 in November 2017.

<sup>25</sup> International Financial Reporting Standard.

## 2.6 Institutions subject to German banking supervision

BaFin's Banking Supervision Directorate was responsible for supervising 1,553 credit institutions at the end of 2017 (see Table 8 "Number of institutions by group of institutions"). They included 63 SIs, i. e. significant institutions or groups of institutions, that are directly supervised by the ECB and are monitored by the joint supervisory teams referred to above.<sup>26</sup> 1,490 institutions were subject to direct banking supervision by BaFin at the end of 2017 – including 1,455 LSIs, or less significant institutions.<sup>27</sup> The number of institutions under supervision has again fallen substantially since 2016. The reason for this is the continuing wave of mergers in the banking industry – in particular in the cooperative sector.

### Division into groups

The Banking Supervision Directorate subdivides the banks into four groups of institutions on the basis of their business model or membership of a particular network: commercial banks, institutions belonging to the savings bank sector, institutions belonging to the cooperative sector and other institutions.

The commercial banks include the major German banks, subsidiaries of foreign banks and the private banks.

**Table 8: Number of institutions by group of institutions**

As at 31 December 2017

	2017	2016	2015
Commercial banks	170	171	179
(of which SIs)	37	37	36
Institutions belonging to the savings bank sector	398	412	422
(of which SIs)	10	11	11
Institutions belonging to the cooperative sector	919	976	1,027
(of which SIs)	3	3	4
Other institutions	66	69	112
(of which SIs)	13	15	16
<b>Total</b>	<b>1,553</b>	<b>1,628</b>	<b>1,740</b>

<sup>26</sup> On the SIs under the direct supervision of the ECB, see the Appendix, page 181.

<sup>27</sup> On the institutions supervised by the Securities Supervision/Asset Management Directorate, see 2.8. On the number of authorised institutions in Germany, see the Appendix, page 181 ff.

The institutions belonging to the savings bank sector comprise the public-sector and independent savings banks together with the *Landesbanks* and DekaBank. The institutions belonging to the cooperative sector continue to form the largest group of institutions; they include the cooperative banks, DZ Bank and three other institutions. The other institutions, the smallest group of institutions, include, among others, *Bausparkassen*, guarantee banks and special-purpose credit institutions.

## 2.6.1 Risk classification

Together with the Deutsche Bundesbank, BaFin produces a risk profile for each of the less significant institutions, i.e. the credit institutions it supervises directly (see Table 9 "Risk classification results of LSIs in 2017"). BaFin updates the risk profile of each of these LSIs at least once a year.

It uses the risk profile of an individual LSI to determine how closely it supervises the institution. In addition to the findings of the audit report for the annual financial statements, current risk analyses and knowledge obtained from special audits and requests for information are also included in the assessment.

BaFin allocates each institution to a risk class on the basis of its risk profile. This risk classification is based on the categories "quality" of the institution and potential "impact" – namely the impact of a solvency or liquidity crisis of the institution on the stability of the financial sector. In comparison with 2016, there were only marginal changes in the allocations to the individual risk classes – while the quality of the institutions showed a slight downward trend, their impact increased slightly.

**Table 9: Risk classification results of LSIs in 2017\***

As at 31 December 2017

Institutions in %		Quality				Total
		1	2	3	4	
Impact	Risk matrix					
	High	0.0	0.4	0.2	0.0	0.6
	Medium	3.7	7.0	1.9	0.3	12.9
	Medium-low	15.8	34.2	5.2	0.3	55.5
	Low	4.8	18.9	6.5	0.8	31.0
<b>Total</b>		<b>24.3</b>	<b>60.5</b>	<b>13.8</b>	<b>1.4</b>	<b>100.0</b>

\*This table presents the LSIs under the supervision of the Banking Supervision Directorate.

## 2.6.2 Special audits

In 2017, BaFin ordered 199 special audits pursuant to section 44 (1) sentence 2 of the Banking Act (see Table 10 "Breakdown of special audits of LSIs by areas of emphasis"). BaFin uses these audits as a supervisory tool if it identifies a greater need for information which is not satisfied by the regular sources of information, namely the reporting system, the direct exchange of information with the institutions and the audit reports for the annual financial statements.

An audit pursuant to section 44 of the Banking Act may be ordered for a specific reason or because too much time has elapsed since the last special audit. The Deutsche Bundesbank is appointed to carry out most of the special audits, but external auditors are also engaged.

**Table 10: Breakdown of special audits of LSIs by areas of emphasis\***

As at 31 December 2017

	2017	2016
Impairment-related special audits	15	19
Section 25a (1) of the Banking Act (MaRisk)	166	149
Cover	13	10
Market risk models	0	1
IRBA (credit risk measurement)	5	4
AMA (operational risk measurement)	0	0
Liquidity risk measurement	0	0
<b>Total</b>	<b>199</b>	<b>183</b>

\* 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.

**Table 11: Breakdown of special audits of LSIs in 2017 by groups of institutions**

As at 31 December 2017

	Commercial banks	Savings bank sector	Cooperative sector	Other institutions
Impairment-related special audits	1	4	10	0
Section 25a (1) of the Banking Act (MaRisk)	15	55	95	1
Cover	0	11	0	2
Market risk models	0	0	0	0
IRBA (credit risk measurement)	4	0	0	1
AMA (operational risk measurement)	0	0	0	0
Liquidity risk measurement	0	0	0	0
<b>Total</b>	<b>20</b>	<b>70</b>	<b>105</b>	<b>4</b>
<b>Audit ratio in %*</b>	<b>16.4</b>	<b>18.0</b>	<b>11.5</b>	<b>12.5</b>

\* 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.

As in the previous year, the audits mainly related to section 25a (1) of the Banking Act. Audits pursuant to section 25a (1) of the Banking Act enable BaFin to form an impression of whether an institution's risk management system is adequate. The minimum conditions that must be satisfied for a risk management system to be adequate are set out in detail in the MaRisk referred to above. 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.<sup>28</sup>

13 cover audits were carried out in 2017. In accordance with the statutory requirement in the German *Pfandbrief Act* (*Pfandbriefgesetz*), the cover for *Pfandbriefe* should normally be audited every two years.

BaFin also ordered five requested special audits in 2017, that is, audits initiated by institutions themselves. These related to recognition of the internal ratings-based approach (IRBA) for credit risk measurement.

Most of the special audits were carried out in the cooperative sector due to the fact that this group has the largest number of institutions (see Table 11

"Breakdown of special audits of LSIs in 2017 by groups of institutions").

BaFin conducted special audits for 12.5 percent of the LSIs under supervision. Table 12 "Breakdown of special audits of LSIs initiated by BaFin in 2017 by risk class" on page 87 provides a detailed analysis of the special audits of LSIs on BaFin's initiative in 2017 for the individual risk classes.

### 2.6.3 Objections and measures

The Banking Supervision Directorate recorded a total of 974 objections and measures (see Table 13 "Supervisory law objections and measures under the Banking Act in 2017" on page 88).<sup>29</sup> This sharp increase compared with the previous year (415 objections and measures) was almost entirely the result of formal measures relating to own funds/liquidity measures. The supervisory measures in 2017 included 902 SREP notices issued.<sup>30</sup>

In general, the approach adopted by Banking Supervision is to make direct contact with the

<sup>28</sup> On the amended MaRisk, see 1.4.1.

<sup>29</sup> On the distinction between measures and sanctions, see 2016 Annual report, page 55 ff. On sanctions under the Banking Act, see chapter II 6.

<sup>30</sup> See 2.1.

**Table 12: Breakdown of special audits of LSIs initiated by BaFin in 2017 by risk class**

As at 31 December 2017

Special audits initiated by BaFin		Quality of the institution				Total	Institutions* in %
		1	2	3	4		
Risk matrix	Impact						
	High	0	2	0	0	2	22.2
	Medium	9	15	2	2	28	14.9
	Medium-low	32	75	10	1	118	14.6
	Low	3	17	12	1	33	7.3
	<b>Total</b>	<b>44</b>	<b>109</b>	<b>24</b>	<b>4</b>	<b>181</b>	<b>12.5</b>
	<b>Institutions in %*</b>	<b>12.5</b>	<b>12.4</b>	<b>11.9</b>	<b>20.0</b>	<b>12.5</b>	

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

institutions concerned at the first indications of deficiencies. The objective is for the institutions to rectify the deficiencies as quickly as possible. In most cases BaFin is successful in motivating the institutions to do so, with the result that formal measures no longer become necessary. BaFin had to take formal measures against an institution's managers or members of its supervisory or administrative boards in 2017 only in isolated cases.

#### Discussions and letters

In addition to regular discussions with representatives of the institutions, BaFin uses letters as an important tool of preventive supervision. It uses them to inform the institutions how it evaluates the findings of the audit of the annual financial statements or how it assesses the findings of a special audit. In these letters, BaFin points out minor deficiencies before they develop into serious deficiencies and formal measures may have to be taken.

### 2.6.4 Situation of the institutions

#### 2.6.4.1 Situation of the private commercial, regional and specialist banks

No group of institutions displays such a wide range of business models as the private commercial, regional and specialist banks. Their strong focus on specialisation allowed some of the institutions to achieve comfortable margins, especially if concentrating on individual niche markets or areas of activity generated competitive advantages.

#### Broader range of services

In order to tap sources of income that are independent of interest rates, a number of institutions – frequently those with strong regional ties – have broadened the range of services they offer beyond traditional banking services to include, for example, real estate development or building management. An increasing readiness to cooperate with other institutions – driven by the need to cut costs – is also noticeable and extends, for example, to securities settlement, setting up investment funds or payment services. Some of the banks – especially those with fintech expertise – have identified the provision of payment services as their market niche.

#### Institutions under pressure

Other institutions were under substantial pressure to develop new areas of business because their business models were not sustainable. This led them to engage in the cross-border purchasing of receivables or to specialise in individual loan portfolios, among other examples. However, because some of the smaller banks were unable to cope with the associated concentration and cluster risks due to inadequate governance and risk management systems, these institutions ran into financial difficulties which threatened their continued existence. This triggered supervisory measures which varied according to the specific circumstances of the individual case.

#### Cum/ex and cum/cum

A number of institutions in this group were affected by the reappraisal of cum/ex and cum/cum transactions by the tax prosecution authorities (in the wake of the

**Table 13: Supervisory law objections and measures under the Banking Act in 2017\***

As at 31 December 2017

Type of measure	Group of institutions				Total
	Commercial banks	Savings bank sector	Cooperative sector	Other institutions	
Substantial objections/letters	8	10	29	16	63
Measures against managers	Dismissal requests***	2	0	0	2
	Cautions	1	0	1	2
Measures against members of supervisory/administrative boards	Dismissal requests***	0	0	1	1
	Cautions	0	0	0	0
Measures related to own funds/liquidity, exceeding the large exposure limit (sections 10, 13 and 45 of the Banking Act)	43	232	618	9	902
Measures in accordance with section 25a of the Banking Act	3	0	0	0	3
Measures in accordance with sections 45, 45b and 46 of the Banking Act**	1	0	0	0	1
<b>Total</b>	<b>58</b>	<b>242</b>	<b>649</b>	<b>25</b>	<b>974</b>

\*These figures relate to less significant institutions (LSIs) only.

\*\*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 6.

Federal Ministry of Finance's letter dated 17 July 2017).<sup>31</sup> Banks' business premises were searched and documentation was seized, including as the result of investigations relating to their clients and not to the relevant credit institutions themselves. Any institution that was itself suspected of tax evasion was confronted with notice of claims for recourse in respect of taxes not paid in the context of a client transaction.

#### 2.6.4.2 Situation of the savings banks

The savings banks achieved a satisfactory overall result during the past financial year. The effects of the persistent low interest rate environment are clearly evident in the income statements of the affiliated institutions, however. For example, net interest income – the most important source of earnings for the savings banks – declined once again, as expected. However, the

impact of the fall in earnings was lessened by rigorous cost-saving measures. As a result, the net profit for the year has returned to the level of previous years.

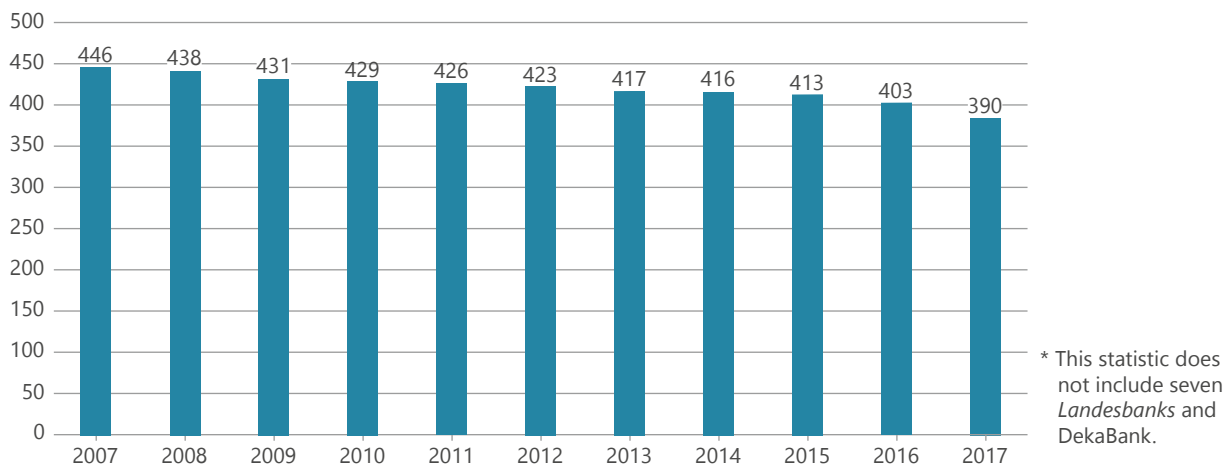
#### Lending business profitable

The savings banks benefited above all from lending to small and medium-sized companies, thanks to increased demand for loans for investments in view of the positive macroeconomic environment. The institutions also achieved growth in commercial and private real estate financing, helped by the historically low rates of interest on loans. Net commissions received continued the modest upward trend of recent years. In order to save costs, the savings banks cut staff numbers and further reduced the number of their branches (see Figure 2 "Number of savings banks" on page 89). Fewer and fewer institutions are offering free current accounts. Expenses for risk provisioning in the lending and securities business rose only slightly compared with the previous year and continue at a very low level. In anticipation of the higher capital requirements

<sup>31</sup> See 2.4.1. and 2.4.2.



**Figure 2: Number of saving banks\***



in the future, the savings banks once again added substantially to their reserves, but not by as much as in 2016.

#### **Compliance with higher capital requirements**

From a regulatory point of view, the increase in the minimum capital requirements was the main issue for the majority of the savings banks in the past financial year. BaFin set individual own funds requirements on the basis of the SREP<sup>32</sup> for around three quarters of the affiliated institutions. The tighter requirements cover interest rate risk in the banking book in particular, but also other material risks not explicitly included in the Pillar I minimum requirements. All of the savings banks complied with the higher capital requirements in 2017. In fact, the aggregated total capital ratio of all savings banks was well above the minimum figure required on average from the individual institutions.

#### **Decline in net profit for the year expected**

The results of the 2017 low interest rate environment survey show that the savings banks are expecting a decline in net profit for the year in all scenarios due to their high degree of dependence on interest income.<sup>33</sup> The institutions are intending to counter this development by improving their commission income, increasing fees received and further enhancing their

efficiency. Overall, the savings banks coped well with the lower interest rate environment thanks to their high level of capital resources. Despite this, the survey results showed that many institutions in this group could envisage a merger with a neighbouring savings bank in the medium term.

#### **2.6.4.3 Situation of the *Bausparkassen***

The continuing low interest rate environment again represented the central challenge for the *Bausparkassen* in 2017. The situation of the sector in 2017 was essentially the same as in the previous year: the proportion of *Bauspar* loans issued continued to decline. This demonstrates that, as before, few *Bauspar* customers are willing to take up the *Bauspar* loans made available by their *Bausparkasse* but not currently bearing a market rate of interest.

At the same time, the renewed increase in *Bauspar* deposits illustrates interest on the part of *Bauspar* customers in older *Bauspar* contracts, featuring a high deposit rate of interest which is also not in line with current market conditions.

#### **Significant impact on results of operations**

This is having a significant effect on earnings across the entire *Bauspar* sector, because the comparatively high expenses for *Bauspar* deposits paying a high rate of interest are not matched by any corresponding income from *Bauspar* loans issued. An additional factor is that the German *Bausparkassen* Act (*Bausparkassengesetz*) essentially restricts the *Bausparkassen* to the residential real estate lending business.

<sup>32</sup> See 2.1.

<sup>33</sup> See 2.2.1 and chapter I 7. The press release on the low interest rate survey is available on BaFin's website at [www.bafin.de/dok/8216350](http://www.bafin.de/dok/8216350) (only available in German).

### Emphasis on building loans

The *Bausparkassen* attempted to counter these negative effects on earnings in 2017 once again. They therefore placed greater emphasis on granting building loans, although by far the majority of the loans issued again consisted of pre-financing and bridging finance loans. The institutions also continued to reduce their personnel expenses and non-staff costs, improved their (IT) processes and – as in previous years – drove ahead with the introduction of tariffs at low rates of interest, in line with the market. Nevertheless, it will take some time before sales of these new tariffs reach a level at which the lower expense for interest on deposits will have a positive effect on the profitability of individual *Bausparkassen*.

### Termination legally permitted

In 2017 once again, the *Bausparkassen* attempted to terminate *Bauspar* contracts in order to reduce the proportion of high-interest building savings contracts in their portfolios. The industry can rely on established case law with respect to the termination of over-saved *Bauspar* contracts, i.e. those contracts where a *Bauspar* loan can no longer be disbursed because the payments by the *Bauspar* customer have already reached the agreed savings target.

The Federal Court of Justice (*Bundesgerichtshof*) also clarified on 21 February 2017 that the termination rules in section 489 (1) no. 2 of the German Civil Code (*Bürgerliches Gesetzbuch*) can be applied to building savings contracts that have been eligible for allocation for over 10 years. As a result, *Bausparkassen* can now also terminate these *Bauspar* contracts in principle without incurring a legal risk.

#### 2.6.4.4 Situation of the cooperative banks

The cooperative banks' performance was satisfactory in the 2017 financial year despite the difficult market environment. The reason for the slight decline in earnings for this group of institutions is also the low interest rate environment; net interest income is now noticeably below the long-term average. The substantial efforts over the past decade to control costs are helping to reduce the impact of the lower net interest income. Despite an expected increase in expenses for measurement losses, which are, however, still well below the long-term average, it is possible to make adequate provision for future risks in the form of reserves.

### Mergers

The scope for consolidation in the sector was seen in 2017, for example, in the merger of the Rhineland-Palatinate cooperative association (*Rheinisch-Westfälischer Genossenschaftsverband*) with the Cooperative Association (*Genossenschaftsverband*) to form the largest German cooperative auditing association. There were also mergers of primary cooperative institutions – as in past years – with the result that the number of primary institutions fell from 972 in the previous year to 915 (see Figure 3 "Number of primary cooperative institutions" on page 91).

### IT audits

In 2017, BaFin audited the IT systems of two service providers in the cooperative sector. The reports on the audits are still being evaluated. Further IT audits are planned for 2018.

BaFin also investigated institutions in the cooperative sector as a result of their involvement in cum/cum transactions.<sup>34</sup> Since the transactions investigated covered several financial years, some of the institutions concerned had to make substantial payments to the tax authorities, which has had a significant impact on their income statements. Whether the claims enforced by the tax authorities are actually valid is the subject of legal disputes.

### Negative interest

Negative interest for retail customers has become a major topic in the cooperative sector. At the present time, this is normally only required for very large deposits. However, institutions are weighing up strategies for charging negative interest on a broader basis.

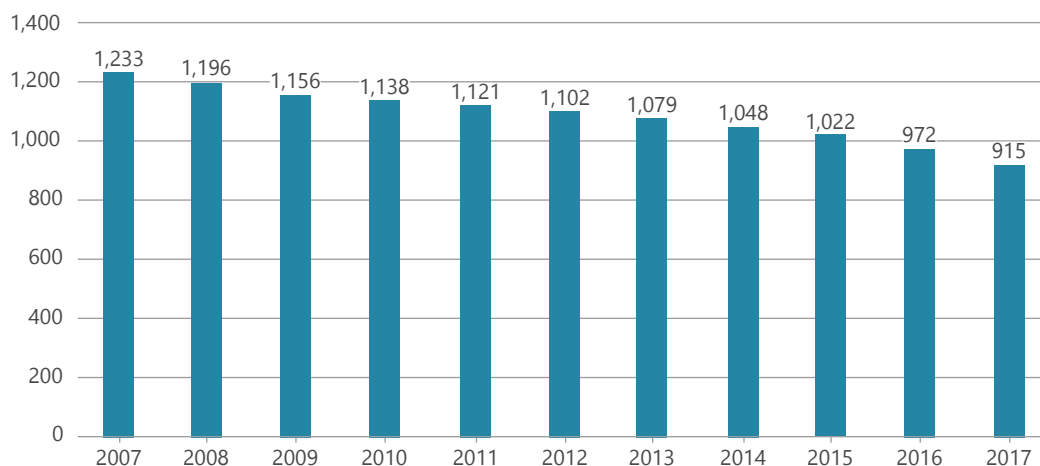
#### 2.6.4.5 Situation of the foreign banks

Foreign banks again played a major role in the German financial market in 2017. The foreign banks located in Germany are concentrated on the deposit business and also on the lending business, private banking, investment banking, custodian bank operations as well as export finance and payment services.

Most of the foreign banking entities located in Germany again qualified as less significant institutions in 2017. The proportion of the less significant institutions treated as having high priority (high-priority less significant institutions – HP LSIs) was unchanged compared with the previous year.

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<sup>34</sup> See 2.4.1.

**Figure 3: Number of primary cooperative institutions****Consequences of Brexit**

It is currently assumed that a number of undertakings will relocate their business operations from the United Kingdom to Germany in the wake of the planned Brexit.<sup>35</sup> This is expected to increase the volume of business of the institutions already located here, and BaFin and/or the SSM will have a large number of authorisation, qualifying holding and EU passporting procedures to process.

**Consequences of the lifting of the Iran sanctions**

Following the extensive lifting of sanctions against Iran in 2016, Iranian credit institutions located in Germany are once again able to conduct banking business. Three of the four Iranian credit institutions that had operations in Germany prior to the imposition of sanctions resumed their business activities in 2017. More Iranian credit institutions have expressed interest in starting operations in Germany.

**2.6.4.6 Situation of the finance leasing and factoring institutions**

The leasing and factoring sector once again recorded growth in new business in 2017. According to figures provided by the Federal Association of German Leasing Companies (*Bundesverband Deutscher Leasing-Unternehmen*)<sup>36</sup>, the leasing industry's new business in equipment goods recorded growth of 7.5 percent in the first half of 2017 compared with the prior-year period. The factoring industry achieved revenue growth

of 8.4 percent according to the German Factoring Association (*Deutscher Factoring-Verband e.V.*).<sup>37</sup>

The number of (pure) finance leasing institutions subject to ongoing supervision by BaFin fell to 318 in 2017 (previous year: 334), while the number of (pure) factoring institutions declined to 159 (previous year: 160). In addition, 32 institutions provided both finance leasing and factoring services (previous year: 26).

**Authorisations**

BaFin approved 11 new applications for authorisation pursuant to section 32 of the Banking Act. A total of 21 authorisations terminated in 2017, mainly as a result of waivers, more rarely due to mergers or because no use was made of an authorisation granted. In 2 cases the authorisation was revoked on the basis of section 35 (1) of the Banking Act, and in 1 further case pursuant to section 35 (2a) of the Banking Act.

BaFin initiated 161 qualifying holding procedures. In these cases, BaFin is required, among other things, to form an idea of the integrity and the objectives of the potential purchaser of a qualifying holding. It must also check the existence and origin of the funds used to make the purchase. Notifications were received of the intention to appoint 109 new members of management or commercial attorneys-in-fact, and notification was given that the appointments of 37 members of supervisory or advisory boards had been completed. It is BaFin's responsibility to review the fitness and propriety of these persons.

<sup>35</sup> See chapter I 1 and chapter II 1.

<sup>36</sup> Federal Association of German Leasing Companies, press release dated 2 August 2017.

<sup>37</sup> German Factoring Association, press release dated 10 August 2017.

## Measures and sanctions

Letters containing advice and caution letters were sent to 17 leasing and factoring institutions. In addition, eight administrative fine proceedings were initiated and two managers were given warnings in accordance with section 36 (2) of the Banking Act. One special commissioner was appointed pursuant to section 45c of the Banking Act and one liquidation order was issued in accordance with section 38 (1) of the Banking Act.<sup>38</sup>

### 2.6.4.7 Situation of the payment institutions and e-money institutions

In 2017, BaFin granted 6 authorisations to provide payment services and 1 authorisation to conduct e-money business under the German Payment Services Supervision Act (*Zahlungsdiensteaufsichtsgesetz*). Existing institutions were affected in particular by the amended version of the Payment Services Supervision Act which came into force on 13 January 2018, since it imposes additional requirements for authorisation. The Payment Services Supervision Act was amended by the German Act Implementing the Second Payment Services Directive (*Gesetz zur Umsetzung der Zweiten Zahlungsdiensterichtlinie*) of 17 July 2017.

Payment institutions and e-money institutions holding an authorisation from BaFin under the Payment Services Supervision Act in force until 12 January 2018 may continue to provide payment services up to 13 July 2018 at the latest, without having an authorisation in accordance with the requirements of the new Payment Services Supervision Act. BaFin therefore informed institutions authorised under the old Payment Services Supervision Act in good time about the additional requirements, to ensure smooth implementation of the notification procedure required under the transitional provisions.

#### Table 14: Gross Pfandbrief sales

As at 31 December 2017

Year	Mortgage Pfandbriefe (€ billion)	Public-sector Pfandbriefe (€ billion)	Total sales (€ billion)
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
2017	36.8	11.9	48.8

<sup>38</sup> For a comprehensive overview of measures and sanctions across the different directorates, see chapter II 6.

## Enquiries from fintech companies

BaFin is also receiving an increasing number of enquiries from fintech companies due to the amendments to the Payment Services Supervision Act and the new requirement for authorisation for payment initiation services and account information services. In anticipation of the amended Payment Services Supervision Act entering into force, BaFin held discussions with the new market participants beforehand to explain the upcoming authorisation procedures.

### 2.6.4.8 Pfandbrief business

The German *Pfandbrief* performed relatively well in 2017 in a difficult market environment. Despite the availability of alternative funding options and the persistently low level of interest rates, total sales of *Pfandbriefe* recorded modest growth. In total, *Pfandbriefe* with a volume of €48.8 billion were sold in the past financial year (see Table 14 "Gross Pfandbrief sales").

Measured by issue volume – €36.8 billion – sales of mortgage *Pfandbriefe* (including ship and aircraft *Pfandbriefe*, although these are niche products) were once again more than three times higher than those of public-sector *Pfandbriefe*. Issues of the latter in 2017 amounted to €11.9 billion.

#### Total volume of outstanding Pfandbriefe

With an outstanding volume of €362.2 billion, the steady decline in the total volume of outstanding *Pfandbriefe* in recent years was halted for the first time in 2017. While the outstanding volume of mortgage *Pfandbriefe* (including ship and aircraft *Pfandbriefe*) rose to €214.0 billion, the volume of public-sector *Pfandbriefe* outstanding amounted to €148.2 billion in 2017, representing another decrease (see Table 15 "Volumes of outstanding *Pfandbriefe*" on page 93).

**Table 15: Volumes of outstanding Pfandbriefe**

Year	Mortgage Pfandbriefe (€ billion)	Public-sector Pfandbriefe (€ billion)	Total outstanding (€ billion)
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
2017	214.0	148.2	362.2

**ECB investments**

Although the volumes of the monthly purchases of the ECB as the largest investor in the covered bond market are declining, the ECB is likely to continue investing heavily in this market in the immediate future, if only to reinvest bonds maturing. As a result of the ECB's influence on the market, margins in the covered bond market are unlikely to increase significantly in the short term, which will probably continue to hold back sales to traditional investors. At the same time, the sector is aiming to broaden its investor base with modern product types – such as the “green Pfandbrief”. The proportion of mortgage Pfandbriefe, currently benefiting from the healthy real estate market, is likely to increase in future. By contrast, there will be a further decline in the importance of the public-sector Pfandbrief, which is mainly still used for funding traditional local government financing requirements and state-backed export finance.

**2.7 Financial services institutions**

At the end of 2017, BaFin's Securities Supervision/ Asset Management Directorate had 722 financial services institutions under its supervision (previous year: 708). It was also responsible for supervising 106 German branches of foreign undertakings (previous year: 94).

45 undertakings applied for authorisation to provide financial services in 2017 (previous year: 32). 12 financial services institutions applied to extend their authorisation to cover the provision of additional financial services (previous year: 8).

The number of tied agents at the end of 2017 was approximately 34,900 and was therefore unchanged (previous year: approximately 34,900). The number of liable undertakings fell slightly in 2017 from 188 to 179.

**Changes due to MiFID II**

Since 3 January 2018, in the wake of the implementation of MiFID II, liable undertakings have only been permitted to enter tied agents in the register of tied agents if they are domiciled in Germany. If a liable undertaking domiciled in Germany enters a tied agent domiciled in another country in the register of tied agents maintained by BaFin, BaFin will write to the institution requesting it to notify the termination of the activities. In the event that the institution does not comply with the request, BaFin can enforce the deletion of the entry compulsorily. If an institution refuses to comply, this may be taken into account when assessing the reliability of the senior management.

In the course of 2017, BaFin participated in 54 audits at financial services institutions (previous year: 39) and conducted 87 supervisory interviews with institutions (previous year: 97).

A total of 29 authorisations held by financial services institutions ended (previous year: 27), in most cases because they were returned.

**New rules for applications for authorisation**

Since 3 January 2018, securities trading firms or banks have been required to comply with Delegated Regulation (EU) 2017/1943 when making an application for authorisation. Section 32 (1) sentence 2 of the German Banking Act (*Kreditwesengesetz*) in conjunction with section 14 of the German Reports Regulation (*Anzeigenverordnung*) no longer apply to them.

Three copies of the application for authorisation must be submitted to BaFin in writing. The application form for authorisation as an investment firm, the form “List of members of the management body” and, where applicable, the notification of information on changes to the membership of the management body must be used for this purpose. The forms can also be found in

the Annex to Implementing Regulation (EU) 2017/1945, which prescribes the use of these common standard forms and templates across Europe in the interests of a uniform procedure.

### **Qualifying holding proceedings**

In the course of a qualifying holding procedure carried out in 2017 in relation to an investment services institution, it came to BaFin's attention that there were various administrative offence proceedings against the intended acquirer, for some of which substantial administrative fines had been imposed. For this reason among others, BaFin had doubts about the financial soundness of the prospective acquirer. After receiving corresponding advice from BaFin, the acquirer abandoned its intention to purchase the significant shareholding in the institution.

A number of convictions of employees or senior managers of investment services institutions under supervision for market manipulation became known in 2017. They related to cases in which investment managers had carried out simultaneous purchases and sales in the same financial instrument for different clients via a stock exchange. In these circumstances, an evaluation of the case from the point of view of supervisory law is also required in addition to criminal sanctions. This may also result in formal measures against the senior managers under administrative law, for example a warning or the removal of the manager.

## **2.8 Securities trading banks**

The Securities Supervision/Asset Management Directorate is also responsible for supervising the solvency and conduct of securities trading banks. The

reason for this is that these institutions are primarily engaged in securities trading and are classified as investment firms.

Because of their specialisation in securities business, the business models of the securities trading banks are different from those of the credit institutions, ranging from traditional brokerage activities on the stock exchanges to own account trading and corporate finance or trading in energy derivatives. With the entry into force of the Markets in Financial Instruments Directive II (MiFID II) on 3 January 2018<sup>39</sup>, further regulated activities have been added, for example systematic internalisation or the operation of a multilateral trading facility (MTF).<sup>40</sup>

### **Competition**

The fierce competition in the business with institutional customers meant that securities trading banks operating in Germany again faced a strongly competitive environment in 2017. One institution reduced the scope of its activities as a result of the capital requirements for securities trading banks and is continuing its business as a financial services institution.

### **One institution insolvent**

In the case of one institution, BaFin arranged a hearing on the proposed revocation of its authorisation due to the persistent absence of risk-bearing capacity in its business model. At the hearing, the institution then indicated that it had become insolvent. In response, BaFin applied to the competent insolvency court to initiate insolvency proceedings in relation to the assets of the institution. Since then, the institution has returned its authorisation as a securities trading bank and wound up all its activities requiring authorisation.

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<sup>39</sup> See chapter I 5 and chapter V 1.1.

<sup>40</sup> See BaFinJournal January 2018, page 6 (only available in German).



# IV

## Supervision of insurance undertakings and *Pensionsfonds*



# 1 Bases of supervision

## 1.1 Global regulatory framework

### 1.1.1 Global capital standards

**T**he International Association of Insurance Supervisors (IAIS) has been working for a number of years on the first global, risk-sensitive solvency regime for insurance groups. BaFin is collaborating on the project and is working hard to achieve compatibility with the European Solvency II<sup>1</sup> framework.

In summer 2017, the IAIS published ICS 1.0, the first version of the Insurance Capital Standard, for extended field testing<sup>2,3</sup>. This global capital standard is intended to apply to all large insurance groups with international operations (Internationally Active Insurance Groups – IAIGs). The field test is intended to try out different options for the various elements of the ICS, including discounting and the criteria for own funds. The findings of the test will be fed into the ongoing development of the ICS from version 1.0 to version 2.0, which should then no longer include any options.

In the next step, the IAIS has begun to analyse the results of the field test which started in May 2017, with the participation of German undertakings. Following intensive discussions in which BaFin was also involved, the IAIS announced in November how the process of transitioning ICS 2.0 from the development phase to the implementation phase from 2020 will function.<sup>4</sup>

#### Next steps

From 2020 onward, the intention is that, during an initial five-year monitoring period, ICS 2.0 will be reported using only market-adjusted valuation. The results that will then be available will provide further information to be used in assessing the solvency of IAIGs, but will not be used as a basis to trigger supervisory action during the monitoring period. The data obtained in this way will also be able to contribute to improved comparability in the supervisory colleges. After completion of the monitoring phase, ICS 2.0 is planned to be introduced



as a prescribed capital requirement (PCR) worldwide according to the wishes of the IAIS and its members.

#### BaFin voices support for internal models

An important concern for BaFin is that, in addition to the standardised method which all undertakings will be required to apply during the monitoring phase, internal models should also be authorised as an equal basis for the purpose of calculating the ICS. During the monitoring period, internal models are intended to be used only on a supplementary basis. It is planned to review their use as a permitted alternative to the standardised method at the latest by the completion of the monitoring phase. The IAIS is currently working on defining the criteria for the application of internal models. This process is scheduled to be completed by the next round of the field test in 2018. Other IAIS members prefer a method based on adjusted accounting standards (GAAP+)<sup>5</sup>, which will also have to satisfy a review after five years. The agreed plan also envisages bringing the different concepts together without delay

1 More on Solvency II under 1.2.

2 Details can be found at [www.iaisweb.org](http://www.iaisweb.org).

3 See also BaFinJournal August 2017, page 47 f. (only available in German).

4 See also BaFinJournal November 2017, page 12 f. (only available in German); on ICS 2.0 see also BaFin 2015 Annual Report, page 168 f.

5 Generally Accepted Accounting Principles.

and defining them in detail, as well as reducing the options in the field test.

One of the issues concerns the methodology used to determine the yield curve for the purpose of discounting the liabilities. At the same time, agreement is needed on a comprehensive method of calculating the risk-free yield curve. The IAIS members must also agree on criteria for allocating the available own funds to different tiers in order that a solvency ratio can be determined. Other unresolved points are the calculation of individual elements of the capital requirements and the calculation of the risk margin.

### 1.1.2 Identification of G-SIIs and ABA

The Financial Stability Board (FSB) did not designate any global systemically important insurers (G-SIIs) in 2017.<sup>6</sup> However, the supervisory measures for G-SIIs remain in force for the nine insurance groups identified in 2016 as before. The FSB stressed that new discussions about designation were planned for 2018, including in the light of progress made on work towards an approach based on the undertakings' different activities (activities based approach – ABA).

#### Direct and indirect systemic risk

The ABA for the purpose of assessing systemic risk in the insurance industry is currently being developed as a supplement to the approach focused on undertakings. BaFin is involved in the development of the ABA. In the undertakings-based approach, the central question is whether the (uncontrolled) insolvency of an undertaking could have a direct negative impact on the financial system (domino effect).<sup>7</sup> The ABA approaches systemic risk from a different point of view. In this case, the critical issue is whether particular activities, undertaken collectively by a number of actors, have the potential to affect the financial markets negatively (tsunami effect). In BaFin's view, this distinction between direct and indirect systemic risk is very important, and both could be combined in a hybrid approach.<sup>8</sup> A hybrid procedure of this kind, which BaFin supports, brings together both perspectives, resulting in a comprehensive monitoring approach – and therefore also a reduction in systemic risk.

The IAIS stepped up work on the ABA in 2017 and published a first consultation paper<sup>9</sup> in December. In the paper, the IAIS sets out a potential framework and a possible scope for an ABA. The framework is based on the IAIS's work to date on systemic risk. In addition to identifying activities posing a potential systemic risk – work that is being carried on in 2018 –, the IAIS intends to match the available supervisory tools against the identified risks of these activities. If this process reveals gaps in the IAIS toolbox, those gaps are planned to be closed.

#### Group of undertakings covered

While only about 50 undertakings were included in the data query for the purpose of the previous identification of G-SIIs, this group should be expanded for an ABA, in the opinion of BaFin. Only then will it be possible to evaluate any possible negative effects of particular activities. BaFin is convinced that the principle of proportionality embedded in Solvency II should also be observed for the purposes of an ABA. This applied both to microeconomic and macroeconomic risks.

## 1.2 European framework

### 1.2.1 Solvency II Review

Solvency II<sup>10</sup> only came into force at the start of 2016 and yet the framework is already being reviewed (see info box "Insurance Supervision annual conference" on page 99). "The fact that we are re-examining the framework critically at such an early stage is envisaged in the Directive, and it also makes sense", says Dr Frank Grund, Chief Executive Director of Insurance and Pension Funds Supervision. Initial experiences had now been gathered and the general environment had changed.

The market value-based approach is not negotiable, according to Grund. "But we want to adjust and improve it", he adds. One example is the standard formula.<sup>11</sup>

#### 1.2.1.1 Review of the standard formula

The European Commission asked the European Insurance and Occupational Pensions Authority (EIOPA) to examine various elements of the Delegated Regulation<sup>12</sup>, which contains the implementing

6 See BaFinJournal December 2017, page 14 (only available in German).

7 See Global Financial Stability Report (GFSR), April 2016, chapter 3, page 90 f., and [http://www.imf.org/~media/websites/imf/imported-full-text-pdf/external/pubs/ft/gfsr/2016/01/pdf\\_text.ashx](http://www.imf.org/~media/websites/imf/imported-full-text-pdf/external/pubs/ft/gfsr/2016/01/pdf_text.ashx).

8 See Hufeld, Felix: A Regulatory Framework for Systemic Risk in the Insurance Industry. In: Hufeld, Felix; Kojien, Ralph S. J.; Thimann, Christian: The Economics, Regulation, and Systemic Risk of Insurance Markets, Oxford University Press, October 2016.

9 <https://www.iaisweb.org/page/news/press-releases/file/70446/iais-press-release-interim-public-consultation-on-an-activities-based-approach>.

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

11 See chapter I 6.

12 Delegated Regulation (EU) 2015/35, OJ EU L 12/1.

## Insurance Supervision annual conference

Around 250 representatives of insurance undertakings and industry associations came to the 7th Insurance Supervision annual conference in Bonn on 11 October 2017. The central themes of the event were Solvency II, digitalisation in the insurance sector and the ongoing development of regulation. In his opening speech, Chief Executive Director Dr Frank Grund gave a report on current issues and the economic situation in the industry. He warned insurers with business operations in the United Kingdom to prepare for the possibility of a hard Brexit. With respect to external run-offs, Grund stressed that BaFin

had not received or been notified of any new applications from life insurers. But “in future cases as well, we will protect the interests of the insured – and not just in financial respects”, he confirmed. Guest speaker Dr Nathalie Berger, Head of Unit at the EU Commission, reported on the ongoing development of insurance regulation from a European perspective.

Following the presentations, industry representatives and supervisors discussed the areas of conflict under Solvency II in practice as well as the risks and opportunities presented by digitalisation.

provisions for Solvency II, by February 2018 in the context of the Solvency II Review. The objective was to simplify the standard formula for the calculation of the solvency capital requirement (SCR) under Solvency II and to create a supervisory regime with appropriate proportionality and technical consistency.

EIOPA submitted the first set of technical advice for the revision of the Delegated Regulation to the European Commission in October 2017. This was followed in November and December by the public consultation exercise for the second set, which was finally published by EIOPA on 28 February 2018. The subject matter for the second set of technical advice consisted of many SCR topics that are significant for the German market and which BaFin negotiated vigorously at European level.

### Interest rate risk

A new methodology is proposed for interest rate risk, which is intended in particular to reflect the low interest rate environment appropriately with negative interest.

### Deferred taxes and risk margin

EIOPA developed a number of guidelines for dealing with the loss-absorbing effects of deferred taxes, which are intended to be applied in particular to the impairment testing of deferred tax assets. For the risk margin, the review was limited to the cost-of-capital rate. The results confirmed the figure of six percent.

### Simplified standard formula

The proposals to simplify the standard formula related in particular to counterparty default risk, catastrophe risk and the look-through approach.

### Removal of technical inconsistencies

Proposals to remove technical inconsistencies were put forward in the non-life premium and reserve risk module, among other areas. For non-life premium and reserve risk, an adjustment of the risk factors was suggested for some business areas, for example legal expenses insurance. In addition, with respect to the volume measure for premium risk, it was suggested that the premium gap existing in the volume measure for multi-year contracts be filled.

### BaFin supports revision

BaFin welcomes the revision of the standard formula. It encouraged German (re)insurers subject to the provisions of Solvency II to take part in the consultations and also participate in the data queries. It was important for the first review of the standard formula to draw attention once again to the particular features of the German insurance business so that – in accordance with their importance for the German market – they are taken into account.

### 1.2.1.2 EIOPA report on long-term guarantees measures

On 21 December 2017, EIOPA for the second time published a report on long-term guarantees (LTG) measures and measures on equity risk, which were anchored in Solvency II with the Omnibus II Directive.<sup>13</sup> EIOPA has established a project specifically for the

<sup>13</sup> <https://eiopa.europa.eu/Publications/Reports/2017-12-20%20LTG%20Report%202017.pdf>.

review of the LTG measures in which representatives of BaFin are participating.

The report describes how the insurers are applying the measures referred to. In addition to the effects of the measures on the solvency situation of the insurance undertakings, it also deals with the impact on the protection of the beneficiaries' interests under the insurance contracts, the availability of insurance products, the investment behaviour of the insurers and the stability of the financial markets.

Furthermore, the report contains data on the extent to which the individual measures are being used in the different markets. An analysis of the information on the application of the LTG and equity risk measures, published by the insurers in their Solvency and Financial Condition Reports (SFCR), also forms part of the report.

### German insurers

For the German market, the transitional measures for the valuation of the technical provisions, the volatility adjustment and the extrapolation of the yield curve represent the three most important LTG measures. In 2017, 82 German insurers applied the volatility adjustment in accordance with section 82 of the German Insurance Supervision Act (*Versicherungsaufsichtsgesetz*). 63 undertakings used the transitional measures for technical provisions pursuant to section 352 of the Insurance Supervision Act.

There will be further LTG annual reports in the next few years. In 2020, EIOPA will draw up recommendations on the LTG measures for the Commission as the result of the work of the project group.

## 1.2.2 Pan-European Personal Pension Product

As part of the planned Capital Markets Union, the EU Commission intends to establish a simple, efficient and competitive EU product for personal pension provision. The Commission presented the first draft of a regulation for this Pan-European Personal Pension Product (PEPP) on 29 June 2017.<sup>14</sup> The draft was based, among other things, on an EIOPA report from 2016<sup>15</sup> as well as the consultation and public hearing of stakeholders on this subject.

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14 See [http://europa.eu/rapid/press-release\\_MEMO-17-1798\\_en.htm](http://europa.eu/rapid/press-release_MEMO-17-1798_en.htm) and 2016 Annual Report, page 138.

15 "Final advice from EIOPA on the development of an EU single market for personal pension products".

The Commission's objective with its proposal is to enable providers of pension products to offer a simple and innovative personal pension product across Europe. The new product is intended to open up a wider range of retirement provision options for savers. PEPPs should have standardised features across the EU and, based on the Commission's proposal, be offered by a variety of businesses: insurers, banks, occupational pension funds, investment firms and asset management companies. PEPPs are intended to supplement the existing statutory, occupational and national personal pension schemes, but should neither replace nor harmonise private provision.

### Tax treatment

The Commission is recommending the member states grant the same tax treatment to PEPPs as to similar national products. The new product category is also intended to contribute to enabling greater flows of savings into long-term investments in the EU, which would also ultimately assist the project of a Capital Markets Union.<sup>16</sup>

The precise details of the PEPPs are currently being negotiated in the relevant working group of the European Council, in which the Federal Ministry of Finance is represented. BaFin will provide support and advice to the Ministry if required.

## 1.3 Occupational retirement provision

### 1.3.1 Implementation of the IORP II Directive

On 13 January 2017, the amended Directive on the activities and supervision of institutions for occupational retirement provision (IORP II) came into effect.<sup>17</sup> The amended version replaces the existing IORP Directive from 2003 and must be transposed into national law within two years.<sup>18</sup>

The IORP II Directive provides for material changes – as compared with the existing Directive – in the qualitative requirements and information obligations.<sup>19</sup> These provisions in particular will be of great significance for the German institutions for occupational retirement provision, the *Pensionskassen* and *Pensionsfonds*, and will create a need to make corresponding changes.

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16 See [http://europa.eu/rapid/press-release\\_IP-17-1800\\_en.htm](http://europa.eu/rapid/press-release_IP-17-1800_en.htm).

17 Directive (EU) 2016/2341, OJ EU L 354/37.

18 Directive 2003/41/EC, OJ EU L 235/10.

19 See 2016 Annual Report, page 138.

### BaFin working group

BaFin has established a working group for the transposition of the IORP II Directive. It will be concerned not just with issues relating to the pure implementation of the Directive into the Insurance Supervision Act or into legal regulations, but also with subordinate legal provisions, such as guidance notices and circulars issued by BaFin. It is already clear that there will be changes or new publications in this area as well. EIOPA also intends address the transposition of the IORP II Directive in 2018. BaFin will participate in EIOPA working groups.

### 1.3.2 Act to Strengthen Occupational Pensions

The German Act to Strengthen Occupational Pensions (*Betriebsrentenstärkungsgesetz*) has created the option of providing pure defined contribution schemes in occupational retirement provision since 1 January 2018 (see info box "Pure defined contribution schemes").<sup>20</sup>

Previously, the German Occupational Pensions Act (*Betriebsrentengesetz*) only allowed for defined benefit plans. In those cases, the employer is liable to the employee for a specified amount of benefit. An advantage of defined benefit plans, which guarantee the benefits, is that they provide a certain planning dependability. A disadvantage of these guarantees is, for example, a relatively low initial pension, since the external pension provider (*Pensionskasse, Pensionsfonds* or life insurance undertaking) must make its calculations on a secure basis. In addition, investments are subject to significant restrictions: only limited investment in real assets is permitted.

The Act to Strengthen Occupational Pensions expands the possible types of plan to include pure defined contribution schemes, where the employer is liable only for paying the contributions to the implementing institution. In the case of defined contribution plans, the implementing institution is not allowed to grant employees guaranteed benefits. This avoids the disadvantages of guarantees. In particular, higher pension payments can be made initially than would be the case if they were subject to a guarantee. Various provisions of the Act to Strengthen Occupational Pensions ensure that, despite the absence of guarantees, pure defined contribution schemes provide employees with a minimum level of protection.

#### Definition

### Pure defined contribution schemes

In the case of pure defined contribution schemes, the employer is only responsible for paying the contributions to the implementing institutions – i. e. *Pensionskassen, Pensionsfonds* or life insurance undertakings –, but not for a specified amount of benefit.

A precondition for using pure defined contribution schemes is a related collective wages agreement. If the parties to the collective wages agreement agree on an occupational pension scheme in the form of a pure defined contribution scheme, they must participate in its implementation and management and therefore accept long-term responsibility. Moreover, there are extensive special supervisory regulations for pure defined contribution schemes which the implementing institutions must comply with in addition to the other requirements of supervisory law. For example, they are required to establish separate guarantee assets (*Sicherungsvermögen*) or a separate investment portfolio for investments. This ensures that they are kept apart from all other investments and – including the income earned – are used only for the benefit of those employees to whom the pure defined contribution scheme was provided. There is a standard catalogue of permitted types of investment and rules governing investment diversification for institutions implementing pure defined contribution schemes.

For pure defined contribution pension schemes, the implementing institutions must grant a pension for the lifetime of the beneficiary, but the amount is not guaranteed. There are specific provisions governing how the amount of that pension must be determined and adjusted subsequently. The effect of this is to prevent arbitrary determinations to the disadvantage of the employees. The implementing institutions are required to take particular account of the pure defined contribution schemes as part of their risk management procedures. This applies especially to the processes for measuring, monitoring and managing the pensions, as well as for limiting their volatility. In addition, there are specific obligations to provide information to BaFin and to the beneficiaries.

<sup>20</sup> For information on the Act to Strengthen Occupational Pensions, see also BaFinJournal July 2017, page 19 ff. (only available in German).

## 1.4 Insurance distribution

### 1.4.1 Implementation of the Insurance Distribution Directive

The EU member states were required to transpose the IDD, the Insurance Distribution Directive<sup>21</sup>, into national law by 23 February 2018 (see info box “Application date delayed”).

German legislators therefore resolved the “Act Implementing Directive (EU) 2016/97 of the European Parliament and of the Council of 20 January 2016 on Insurance Distribution and Amending Further Laws” and promulgated the Act in the Federal Law Gazette on 28 July 2017.<sup>22</sup> Some of the provisions, such as the ban on special payments and the sharing of commissions (section 48b of the Insurance Supervision Act), came into force with immediate effect on the following day.

The amendments to existing legislation are not derived solely from the IDD. The ban on special payments and the sharing of commissions (section 48b of the Insurance Supervision Act) and the pass-through provision on crediting customers with commissions included in premiums (section 48c of the Insurance Supervision Act) constitute particular features of national law for the purpose of consumer protection.

BaFin will pay particular attention to compliance with the pass-through provision in future in order to support the promotion of fee-based advisory activities intended by the legislation. The aim is that policyholders should benefit from the premium reductions provided for in section 48c of the Insurance Supervision Act. At the same time, however, there is no intention to neglect traditional forms of distribution such as insurance mediation. BaFin’s understanding of the delegated regulation on insurance-based investment products is that commission-based distribution should not be banned or hindered disproportionately, and also bases its supervisory practice on this understanding.

#### Legislative acts relating to the IDD

At the end of December 2017, two delegated regulations based on the IDD were published in the Official Journal of the European Union, dealing primarily with the distribution of insurance-based investment products<sup>23</sup>

#### Note

### Application date delayed

In mid-November 2017, the EU Commission accepted a proposal by the EU Parliament and the member states to push back the start date for the application of the IDD by the insurance industry from 23 February to 1 October 2018. This does not apply to the member states, however; they are now required to transpose the IDD into national law by 1 July 2018 at the latest. The amendments to the Insurance Supervision Act, the German Insurance Contract Act (Versicherungsvertragsgesetz) and the German Industrial Code (Gewerbeordnung) adopted by German legislators in July 2017 are not affected by this, and have applied without restriction since 23 February 2018.

and the product approval process<sup>24</sup>. In addition to the delegated regulations of the EU Commission, an implementing regulation was adopted which sets out a standardised presentation format for a product information document for (non-life) insurance products.<sup>25</sup>

Furthermore, EIOPA published the “Guidelines under the Insurance Distribution Directive on Insurance-based investment products that incorporate a structure which makes it difficult for the customer to understand the risks involved”, on the basis of Article 30(7) and (8) of the IDD. The Guidelines set out criteria enabling national supervisory authorities as well as insurance intermediaries and/or insurance undertakings to assess whether an insurance-based investment product is complex.

Insurance-based investment products classified as complex should not be allowed to be distributed without advice by telephone or online (execution-only sales). Execution-only sales are possible in principle for non-complex insurance-based investment products, provided that the relevant member state decided to make use of the execution-only option (Article 30(3) of the IDD) when it transposed the Directive, and provided that the further pre-conditions of Article 30(3) of the IDD are met. BaFin will incorporate the Guidelines into its supervisory practice.

21 Directive (EU) 2016/97, OJ EU L 26/19.

22 Federal Law Gazette I 2017, page 2789.

23 Delegated Regulation (EU) 2017/2359, OJ EU L 341/8.

24 Delegated Regulation (EU) 2017/2358, OJ EU L 341/1.

25 See chapter II 2.6.1.

## 1.4.2 Product approval process

Article 25 of the IDD specifies product oversight and governance requirements for the distribution of insurance products, frequently referred to as the “POG” requirements. The product approval process based on the IDD, under section 23 (1a) to (1c) of the Insurance Supervision Act, and the European requirements apply to primary insurance undertakings falling within the scope of the Solvency II Directive. Insurance products whose purpose is to insure against large risks within the meaning of section 210 (2) of the Insurance Contract Act are not affected.

The product approval process, which is intended to protect consumers, formulates requirements for the product manufacturer, but also for insurance undertakings if they take responsibility for distribution on behalf of other insurers, especially within groups (see section 23 (1c) of the Insurance Supervision Act). The product approval process forms part of the insurance undertaking’s system of governance and is subject to the proportionality principle.

### Product approval policy

In their capacity as product manufacturers, insurance undertakings are required to develop a product approval policy which defines the requirements for the product approval process, and then to apply that product approval process for each specific new insurance product or each significant adaptation of an existing insurance product.

The product approval policy must be set out in a written internal document – described as the “product oversight and governance policy” within the meaning of the Delegated Regulation referred to above<sup>26</sup>.

In the product approval process, the insurance undertakings must in particular identify a target market for the insurance products they have manufactured. The target market describes the targeted group of customers at an abstract level. The insurer must consider whether the product meets the needs, objectives and characteristics of the target market over the course of its entire life. Distribution outside the target market may be permitted. Relations with customers are governed by the civil law requirements for providing customers with advice and information.

<sup>26</sup> Delegated Regulation (EU) 2017/2358, OJ EU L 341/1.

## 1.5 Regulations

### 1.5.1 Audit Report Regulation issued by the Federal Ministry of Finance

The new German Regulation on Auditors’ Reports (*Prüfungsberichteverordnung*) issued by the Federal Ministry of Finance (*Bundesministerium der Finanzen*) entered into force on 1 August 2017.<sup>27</sup> The amended version replaces the 1998 Regulation which was effective until 31 March 2016. For BaFin, audit reports are a crucial source of information on the business position of the undertakings under supervision. The Regulation on Auditors’ Reports sets out in detail the Supervisory Authority’s requirements for the contents of audit reports as well as for the type and scope of the reporting.

### 1.5.2 Insurance Reporting Regulation

On 31 July 2017, a new German Insurance Reporting Regulation (*Verordnung über die Berichterstattung von Versicherungsunternehmen gegenüber der Bundesanstalt für Finanzdienstleistungsaufsicht*) issued by the Federal Ministry of Finance was published in the Federal Law Gazette.<sup>28</sup> It replaces the version which was effective until 31 March 2016. The new Regulation was applicable for the first time to financial years beginning after 31 December 2015. Quarterly reporting for financial years that began prior to 1 January 2017, however, was still subject to the provisions of the version of the Regulation in force until 31 March 2016.

The Insurance Reporting Regulation sets out the reporting obligations of insurance undertakings to the Supervisory Authority on the basis of accounting information. BaFin continues to require this information about the business activities of the undertakings supervised, including from undertakings subject to the requirements of the Solvency II Directive and the related reporting obligations.

The scope of the reporting has changed in some respects compared with the previous legislation. The existing national reporting obligations have been reviewed and amended in the light of the introduction of the Solvency II reporting framework. The aim was to avoid duplicating the submission of information and to take account of the revised priorities for supervisory

<sup>27</sup> Federal Law Gazette I 2017, page 2846. For information on the draft regulation, see the 2016 Annual Report, page 141 f.

<sup>28</sup> Federal Law Gazette I 2017, page 2858.

activities in the wake of the introduction of Solvency II. Some of the existing reporting obligations have ceased to apply as a result or will do so following a transitional period. At the same time, some reporting requirements for life insurance undertakings had to be expanded to reflect legislative changes (German Life Insurance Reform Act (*Lebensversicherungsreformgesetz*)) in supervisory reporting in the meantime.

### 1.5.3 First Regulation amending the RfB Regulation

As a result of the transposition of the Solvency II Directive into German law, references to the amended version of the Insurance Supervision Act and other revised regulations had to be changed in the Federal Ministry of Finance's Regulation on the Collective Portion of the Provision for Bonuses (RfB Regulation). The First Regulation amending the RfB Regulation was issued for this purpose and became effective on 1 August 2017.<sup>29</sup> This did not result in any substantive changes to the RfB Regulation.

### 1.5.4 Second Regulation amending regulations pursuant to the Insurance Supervision Act

The German Regulation on Audits by Independent Experts (*Sachverständigenprüfverordnung*), the German Remuneration Regulation for the Insurance Industry (*Versicherungs-Vergütungsverordnung*), the German Health Insurance Supervision Regulation (*Krankenversicherungsaufsichtsverordnung*), the German Capital Resources Regulation (*Kapitalausstattungsverordnung*), the German Minimum Allocation Regulation (*Mindestzuführungsverordnung*) and the German Regulation on the Supervision of *Pensionsfonds* (*Pensionsfonds-Aufsichtsverordnung*) issued by the Federal Ministry of Finance also had to be amended. The Second Regulation amending regulations pursuant to the Insurance Supervision Act was issued for this purpose and became effective on 1 August 2017.<sup>30</sup>

Most of the amendments consisted of updating references. However, the Regulation on the Supervision of *Pensionsfonds* was expanded in the newly formulated chapter 7 to include rules on the implementation of defined contribution commitments with a minimum payment pursuant to section 236 (2a) of the Insurance Supervision Act. If the parties to the collective wages

agreement consent, this provision for the first time also allows *Pensionsfonds* to use a structure for the payout phase for defined contribution commitments with a minimum payment that is not insurance-based.

The Regulation on the Supervision of *Pensionsfonds*, with reference to the authorisation to issue regulations in section 236 (2b) of the Insurance Supervision Act, now governs the initial amount, minimum amount and adjustment of lifetime payments to the beneficiaries, as well as the form, content and evidence of the employer's commitment to make the minimum payment.

Amendments were also made to the *Pensionsfonds'* reporting obligations to BaFin in Statements 801 and 830. *Pensionsfonds* must now provide a more detailed analysis of certain data in relation to the different types of business in which they engage.

## 1.6 BaFin circulars

### 1.6.1 Investment Circular

On 12 December 2017, BaFin published Investment Circular 11/2017 (VA) for Solvency I undertakings.<sup>31</sup> It contains guidance on investing the guarantee assets and is aimed at all undertakings authorised to engage in primary insurance business and which are subject to the provisions for small insurance undertakings (sections 212 to 217 of the Insurance Supervision Act), as well as at German *Pensionskassen* and *Pensionsfonds*.

The Investment Circular sets out the provisions of the Investment Regulation and chapter 4 of the Regulation on the Supervision of *Pensionsfonds* in detail. Among other items, it contains a new provision for the treatment of debt instruments eligible for bail-ins and stresses the undertaking's own responsibility for checking that investments meet the qualification criteria for guarantee assets. The Circular also contains separate guidance on the investment of *Pensionsfonds'* guarantee assets for the first time.

Circular 11/2017 (VA) replaces Circular 4/2011 (VA) on the investment of restricted assets held by insurance undertakings. BaFin has incorporated interpretative decisions on Circular 4/2011 (VA) published in the meantime into the new Investment Circular. It has withdrawn Circular 1/2002 (VA) on investments in asset-backed securities and credit-linked notes as well as Circular 7/2004 (VA) on investments in hedge funds. The guidance contained in these Circulars that

<sup>29</sup> Federal Law Gazette I 2017, page 3037.

<sup>30</sup> Federal Law Gazette I 2017, page 3023.

<sup>31</sup> [www.bafin.de/dok/10292296](http://www.bafin.de/dok/10292296) (only available in German).



is still applicable has also been integrated into the new investment Circular. This has resulted in a reduction in the number of circulars applying to Solvency I undertakings.

### 1.6.2 Derivative financial instruments and structured products

BaFin has revised Circulars 3/2000 (VA) and 3/1999 (VA) and combined them in a new Circular 8/2017 (VA) "Derivative financial instruments and structured products"<sup>32</sup> for Solvency I undertakings. It is aimed at all primary insurance undertakings that are subject to the provisions for small insurance undertakings (sections 212 to 217 of the Insurance Supervision Act) as well as at German *Pensionskassen* and *Pensionsfonds*. The Circular contains guidance for the use of derivatives and for investments in structured products.

The revision was necessary because since the publication of the preceding circulars, BaFin had extended the scope of section 15 (1) sentence 2 of the Insurance Supervision Act by means of a number of interpretative decisions. This had resulted in significantly tighter requirements for the risk management system. In addition, insurance undertakings and institutions for occupational retirement provision fall within the scope of the European Market Infrastructure Regulation.<sup>33</sup> The new Circular 8/2017 (VA) reflects the new provisions of European law. BaFin has also included revised terminology and products.

### 1.6.3 Changes to internal models

On 27 April 2017, BaFin published its Circular 4/2017 (VA), which is directed at all insurance groups as well as primary insurers and reinsurers that have been authorised to use an internal model for the purpose of calculating their solvency capital requirements.<sup>34</sup>

#### Specific provisions

The Circular sets out the specific provisions for the interaction of the undertakings with BaFin when applying for major changes to the model and reporting minor changes to the model and their accumulation. BaFin provided more detail for the guidance on accumulating minor changes in an additional publication on 10 October 2017.<sup>35</sup> The Circular also provides

guidance on the difference between changes to the model and model extensions, on changes to the policy and to the internal model as well as on simultaneous applications.

### 1.6.4 Guarantee assets (*Sicherungsvermögen*)

On 13 June 2017, BaFin published the recast of its Circular on the establishment and maintenance of the register of assets and on the safe custody of the guarantee assets. The new Circular 6/2017 (VA)<sup>36</sup> is directed solely at Solvency II undertakings and came into effect on 1 January 2018. The provisions of the Circular comply with the prudent person principle in accordance with section 124 (1) of the Insurance Supervision Act.

The predecessor Circular was in need of revision, because the investment rules had changed when the new Insurance Supervision Act came into force on 1 January 2016. The Insurance Supervision Act now makes a distinction between Solvency I and Solvency II undertakings in relation to the investment of the guarantee assets. BaFin had published the guarantee assets Circular for Solvency I undertakings on 1 December 2016.<sup>37</sup> This Circular also entered into force on 1 January 2018.

### 1.6.5 Minimum bonus (*Mindestbeitragsrückerstattung*)

In 2017, BaFin also replaced Circular 12/2009 (VA) with Circular 7/2017 (VA). The new Circular contains guidance on how life insurers have to inform BaFin about the amounts used to calculate the minimum bonus.

At the same time, BaFin has provided a new template for the purpose of calculating the minimum allocation to the provision for bonuses. The new template also reflects the collective portions which life insurers may establish within the provision for bonuses.<sup>38</sup> In addition, it records the disclosures on the participation of the insureds in the returns for the respective financial year, which the undertakings are required to publish in electronic form on the basis of section 15 (1) of the German Minimum Allocation Regulation (*Mindestzuführungsverordnung*).

32 [www.bafin.de/dok/9959998](http://www.bafin.de/dok/9959998) (only available in German).

33 Regulation (EU) No 648/2012, OJ EU L 201/1.

34 [www.bafin.de/dok/9945668](http://www.bafin.de/dok/9945668).

35 [www.bafin.de/dok/10099514](http://www.bafin.de/dok/10099514) (only available in German).

36 [www.bafin.de/dok/9442026](http://www.bafin.de/dok/9442026) (only available in German).

37 [www.bafin.de/dok/8623674](http://www.bafin.de/dok/8623674) (only available in German).

38 See BaFinJournal April 2015, page 21 (only available in German).

## 1.6.6 Guidance on the conduct of kidnap and ransom insurance

Circular 3/1998 (VA)<sup>39</sup> contains guidance on offering kidnap and ransom insurance. Among other things, it provides that the latter may not be bundled together with other insurance contracts and that insurance cover may not be provided in combination with other classes and types of insurance.

### New decision by BaFin

BaFin has now decided to accept the bundling of kidnap and ransom insurance with cyber risk insurance in one contract in the future.<sup>40</sup> The rest of the preconditions for offering kidnap and ransom insurance set out in Circular 3/1998 (VA) continue to apply. Cyber risk insurance may, therefore, be promoted as such, while the kidnap and ransom insurance component may not be.

Offering kidnap and ransom insurance was not permitted in Germany for a long time, because this business model was considered to be incompatible with essential principles of German law. However, the Federal Insurance Supervisory Office (*Bundesaufsichtsamt für das Versicherungswesen*) abandoned this strict position in 1998. Since then, insurance against product extortion and ransom demands has been allowed subject to certain preconditions.

BaFin has already amended the Circular on three occasions since it was issued. In 2000, the requirement for separate authorisation was dropped<sup>41</sup> and BaFin has permitted automatic renewals subject to certain preconditions since 2008.<sup>42</sup> In 2014, it gave its approval, as an exception, for more than three persons at commercial policyholders to have knowledge that kidnap and ransom insurance has been taken out.<sup>43</sup>

## 1.7 Interpretative decisions

### 1.7.1 Sovereign risk

Insurers holding government bonds or loans to sovereigns in their portfolios must address the associated risks, irrespective of the capital charge. This applies in particular with respect to the prudent person

principle, the own credit risk assessment and the own risk and solvency assessment. These requirements are derived from the Insurance Supervision Act and are set out in detail in the EIOPA guidelines on the system of governance and on the own risk and solvency assessment.

### New interpretative decision

BaFin developed good practice principles for the treatment of risk in the course of a symposium and a workshop with industry representatives, and summarised them in an interpretative decision which it published on 7 April 2017.<sup>44</sup> Insurers can use this good practice approach as guidance for undertakings' individual treatment of sovereign risk. The principles and processes illustrated could also be applied analogously, where appropriate, to the treatment of risk attaching to other investment classes, making allowance for the circumstances of the specific case.

### 1.7.2 Derivatives

BaFin set out details of the prudent person principle in its interpretative decision on the use of derivative financial instruments in the context of the prudent person principle (section 124 of the Insurance Supervision Act)<sup>45</sup> dated 14 July 2017. Among other items, the interpretative decision contains definitions of efficient portfolio management and effective risk transfer and illustrates possible methods of demonstrating effective risk transfer.

Pursuant to section 124 (1) sentence 1 of the Insurance Supervision Act, insurance undertakings falling within the scope of the Solvency II Directive<sup>46</sup> must invest their entire assets in accordance with the prudent person principle. They are not required to comply with the Derivatives Circular 3/2000 (VA) or the successor Circular 08/2017 (VA) on derivative financial instruments and structured products<sup>47</sup>. Instead, the use of derivative financial instruments is permitted under section 124 (1) no. 5 of the Insurance Supervision Act if they contribute to reducing risk or to more efficient portfolio management. Arbitrage transactions or short sales are not permitted.

39 Official Bulletin of the Federal Insurance Supervisory Office (*Bundesaufsichtsamt für das Versicherungswesen – BAV*) 1998, page 182.

40 See BaFinJournal September 2017, page 4 (only available in German).

41 Official Bulletin of the BAV 2000, page 171.

42 See BaFinJournal March 2008, page 3 (only available in German).

43 See BaFinJournal June 2014, page 5 (only available in German).

44 [www.bafin.de/dok/9133240](http://www.bafin.de/dok/9133240) (only available in German).

45 [www.bafin.de/dok/9716538](http://www.bafin.de/dok/9716538) (only available in German).

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

47 See 1.6.4.

## 1.8 Guidance notices

### 1.8.1 Authorisation of insurance joint-stock companies for the pursuit of reinsurance business

On 1 March 2017, BaFin published an updated guidance notice with guidelines and explanatory notes on the authorisation procedure and authorisation requirements for undertakings intending to engage in reinsurance business only.<sup>48</sup> Among other things, the guidance notice provides details of the documentation and information that companies must submit to BaFin with an application for authorisation to conduct business. A number of specific requirements apply to reinsurance undertakings and these are addressed by the guidance notice. The guidance notice replaces the corresponding publication from 2008 and updates the advice and explanatory notes to reflect the changes in the legal situation. An English-language version of the guidance notice is also available on BaFin's website.<sup>49</sup>

### 1.8.2 Authorisation of insurance joint-stock companies for the pursuit of health insurance business

On 10 March 2017, BaFin also published a new guidance notice with guidelines for the authorisation of insurance joint-stock companies for the pursuit of health insurance business as primary insurance undertakings in Germany.<sup>50</sup> The guidance notice provides details of the documentation and information that companies must submit to BaFin to enable it to assess whether it is able to grant authorisation. It also sets out the special requirements applying to small insurance undertakings within the meaning of section 211 of the Insurance Supervision Act. The guidance notice replaces the old version from 2006. The revision was necessitated by the implementation of Solvency II into German law.

### 1.8.3 Update of the guidelines on reporting

BaFin updated the guidelines on reporting for primary insurance and reinsurance undertakings and insurance groups and published them in December 2017.<sup>51</sup> In contrast to the most recent update in March 2017, the elements of narrative reporting were the main focus this time. BaFin included in the update its experience

with the Solvency and Financial Condition Report mentioned above, which was required to be published for the first time in 2017. BaFin also addressed questions on Solvency II reporting from the primary insurers and reinsurers as well as the insurance groups. The guidelines only deal with technical matters and are regularly revised and updated.

## 2 Supervision in practice

### 2.1 Supervisory disclosures

One of the aims of Solvency II is to improve transparency in the insurance sector. Undertakings and supervisors are therefore required to provide comprehensive information to the public. For example, the supervisory authorities must disclose the legal bases for Solvency II, report on their objectives and supervisory activities and publish aggregated statistical data about the industry. BaFin's disclosure obligations are governed by section 318 and section 319 of the German Insurance Supervision Act (*Versicherungsaufsichtsgesetz*). The rules are set out in detail in the Delegated Regulation (EU) 2015/35<sup>52</sup> (Articles 316 and 317 together with Appendix XXI) and in the implementing technical standard on the templates and structure for the information the supervisory authorities have to disclose.<sup>53</sup>

BaFin was required to comply with the newly established disclosure obligations for the first time in 2017. For this purpose, it has published relevant information jointly with the supervisory authorities of the federal states on its homepage.<sup>54</sup>

### 2.2 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 *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.

48 [www.bafin.de/dok/8960864](http://www.bafin.de/dok/8960864).

49 [www.bafin.de/dok/8960864](http://www.bafin.de/dok/8960864).

50 [www.bafin.de/dok/9045698](http://www.bafin.de/dok/9045698).

51 [www.bafin.de/dok/7851368](http://www.bafin.de/dok/7851368) (only available in German).

52 Delegated Regulation (EU) 2015/35, OJ EU L 12/1.

53 Implementing Regulation (EU) 2015/2451, OJ EU L 347/1224.

54 [www.bafin.de/dok/10010754](http://www.bafin.de/dok/10010754).

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).

Table 16 shows the assessment based on the data as at 31 December 2017:

#### Number of good-quality insurers at previous year’s level

In the course of the risk classification, BaFin rated 70.8 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. As in the previous years, BaFin did not rate any insurers with high or very high market relevance as an undertaking with low quality.

#### Results in the individual insurance classes

The development of the quality of the property/casualty insurance undertakings generated only minor divergences from the previous year, with more than 80 percent of the undertakings rated as “A” or “B”, as before.

The assessment of the health insurers recorded a deterioration in quality, however. The proportion of health insurers rated “A” or “B” declined overall: more than 70 percent of the health insurance undertakings

were rated “A” or “B”. By contrast, there was an increase in the proportion rated “C”.

The assessment of life insurers also recorded minor changes, although the majority of the life insurers continued to be classified in the medium quality range.

The proportions of *Pensionsfonds* rated “B” and “C” both increased by around three percentage points, with a corresponding decline in the undertakings classified as “A”.

There was a fall of around seven percentage points in the *Pensionskassen* classified in the medium quality bracket. The proportions of *Pensionskassen* assessed as “A” and “D” both showed an increase.

There were no noteworthy movements between quality categories for reinsurers, on the other hand. The proportion in the upper range in the year under review was more than 82 percent, as before.

#### Number of insurers classified continues to decline

The number of undertakings classified during the year under review declined compared with the previous year. The reduction in the number of undertakings classified mainly reflected the decision to exclude the funeral expenses funds from the risk classification in line with the principle of proportionality.

#### Classification of insurance groups

As well as classifying the risks associated with individual insurance undertakings, BaFin will also classify all insurance groups subject to Solvency II for which it had responsibility for group supervision at group level in 2017. In contrast to a purely mathematical aggregation of the classification results of the individual

**Table 16: Risk classification results for 2017**

	Undertakings in %	Quality of the undertaking				Total
		A	B	C	D	
Market impact	very high	0.0	1.7	1.0	0.0	2.7
	high	1.3	6.9	3.3	0.0	11.5
	medium	1.2	15.6	8.1	0.0	24.9
	low	7.1	37.0	13.9	2.9	60.9
	<b>Total</b>	<b>9.6</b>	<b>61.2</b>	<b>26.3</b>	<b>2.9</b>	<b>100.0</b>

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. It 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.

## 2.3 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 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 115 on-site inspections compared with 105 in 2016. 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.

Table 17 shows the breakdown of the inspections by risk class:

## 2.4 Investments of primary insurers

### 2.4.1 Overview

As at 31 December 2017, the carrying amount of the aggregate investments managed by German primary insurers under BaFin's supervision amounted to €1,517.1 billion (previous year: €1,467.8 billion), as shown in Table 18 on page 111.<sup>55</sup> Aggregate investments grew by 3.4 percent (+€49.3 billion) in 2017. Broken down by insurance classes, *Pensionskassen* (+5.8 percent) and health insurers (+4.8 percent) recorded the largest percentage increases. Only the funeral expenses funds recorded a slight decline in investments compared with the prior-year figure.

#### Focal area

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 13.7 percent to €267.9 billion in the year under review, while the share of investments at credit institutions declined year on year.

Indirect investments held by insurance undertakings via investment funds again recorded above-average growth in 2017 (+7.4 percent), and – as in the previous year – now account for over one-third of the aggregate investments of all primary insurers at €542.1 billion.

**Table 17: Breakdown of on-site inspections by risk class in 2017**

	On-site inspections	Quality of the undertaking				Total	Undertakings in %
		A	B	C	D		
Market impact	very high	0	13	0	0	13	12.1
	high	1	20	9	0	30	28.0
	medium	6	14	10	0	30	28.0
	low	3	22	8	1	34	31.8
	<b>Total*</b>	10	69	27	1	107	<b>100.0</b>
	<b>Undertakings in %</b>	<b>9.3</b>	<b>64.5</b>	<b>25.2</b>	<b>0.9</b>	<b>100.0</b>	

\* Eight on-site inspections were also conducted at unclassified undertakings, bringing the total to 115 inspections.

<sup>55</sup> For details of the investments of the individual insurance classes and the *Pensionsfonds*, see 2.5.

**Table 18: Investments of primary insurers\***

Investments of primary insurers (carrying amounts, HGB)	Portfolio as at 31 December 2017		Portfolio as at 31 December 2016		Change in 2017	
	in € million	in %	in € million	in %	in € million	in %
	35,063	2.3	32,929	2.2	2,134	6.5
Fund units, shares in investment stock corporations and investment companies	542,047	35.7	504,727	34.4	37,320	7.4
Loans secured by mortgages and other land charges and shareholder loans to real estate companies	63,019	4.2	59,338	4.0	3,681	6.2
Securities loans and loans secured by debt securities	1,183	0.1	1,180	0.1	3	0.3
Loans to EEA/OECD states, their re- gional governments and local authori- ties and international organisations	128,681	8.5	127,481	8.7	1,200	0.9
Corporate loans	16,185	1.1	14,742	1.0	1,443	9.8
ABSs/CLNs	5,514	0.4	6,392	0.4	-878	-13.7
Policy loans	2,660	0.2	2,927	0.2	-267	-9.1
Pfandbriefe, municipal bonds and other bonds issued by credit institutions	193,114	12.7	205,287	14.0	-12,173	-5.9
Listed bonds	267,892	17.7	235,645	16.1	32,247	13.7
Other bonds	23,617	1.6	22,077	1.5	1,540	7.0
Subordinated debt assets/profit participation rights	23,219	1.5	24,868	1.7	-1,649	-6.6
Book-entry securities and open market instruments	644	0.0	630	0.0	14	2.2
Listed equities	1,633	0.1	1,662	0.1	-29	-1.7
Unlisted equities and interests in companies, excluding private equity holdings	34,733	2.3	44,520	3.0	-9,787	-22.0
Private equity holdings	18,841	1.2	14,936	1.0	3,905	26.1
Investments at credit institutions	139,062	9.2	148,591	10.1	-9,529	-6.4
Investments covered by the enabling clause	18,961	1.2	18,758	1.3	203	1.1
Other investments	1,056	0.1	1,122	0.1	-66	-5.9
<b>Total investments</b>	<b>1,517,124</b>	<b>100.0</b>	<b>1,467,814</b>	<b>100.0</b>	<b>49,310</b>	<b>3.4</b>
Life insurers	909,156	59.9	885,120	60.3	24,036	2.7
Pensionskassen	164,090	10.8	155,044	10.6	9,046	5.8
Funeral expenses funds	2,055	0.1	2,059	0.1	-3	-0.2
Health insurers	273,044	18.0	260,654	17.8	12,390	4.8
Property/casualty insurers	168,779	11.1	164,939	11.2	3,840	2.3

\* The figures are based on the primary insurers' quarterly reports for the fourth quarter of 2017 and are only preliminary.

As in previous years, the assets acquired via investment funds consist mostly of listed securities. Aggregate direct investments in property rose by 6.5 percent year on year to €35.1 billion.

## 2.4.2 Search for yield

Towards the end of 2016, BaFin carried out a survey on behalf of EIOPA into insurers' investment behaviour.<sup>56</sup> BaFin added its own questionnaire<sup>57</sup> to this survey. The aim was to investigate the "search for yield" behaviour (see the info box "Search for yield") of the German insurance industry. The 35 insurers (insurance undertakings and groups, *Pensionsfonds* and *Pensionskassen*) participating in the survey were asked to what extent they had changed the structure of their investment portfolios between 2011 and 2015 in pursuit of higher yields. They were also invited to provide a forecast for the period from 2016 to 2018.

### Findings

The survey found that insurers had been moderate in their search for yield over the past five years and intended to continue this approach going forward, albeit to a lesser extent. Between 2011 and 2015, the search for yield was characterised by longer maturities of new investments, shifts in the primary investment classes (for instance from fixed income securities to equities) and a higher share of infrastructure investments. Looking to the future, it is becoming clear that infrastructure investments will be a focal area for the insurance undertakings.

## 2.4.3 Climate change

As providers of insurance products, insurers are affected by the direct consequences of climate change,

for example in the form of natural disasters such as floods, storms and heatwaves, to an ever greater extent. However, also from an investor's perspective climate change is increasingly drawing the attention of insurers.<sup>58</sup>

### Transformation risks

Undertakings that do not attach importance to sustainability criteria are exposing themselves to risks. For example, the shift from CO<sub>2</sub>-intensive to climate-friendly business activities could result in substantial falls in value in the case of oil, gas and coal enterprises. In particular, investors with long-term strategies such as life insurance undertakings and pension funds should therefore know the related risks.

### Present regulatory framework

Regulation by European and German legislators currently attaches great importance to transparency requirements relating to aspects of sustainability, known as environmental, social and governance (ESG) criteria. Directive 2014/95/EU<sup>59</sup> provides that, as of the financial year starting in 2017, certain undertakings and groups are required to include in their group management report a statement containing information relating to non-financial key performance indicators, such as environmental aspects.

### Consideration of environmental issues

Life insurers that perform services related to occupational retirement provision must inform their customers at the beginning of the insurance relationship how they take environmental issues into consideration in applying the contributions paid in. Insurers subject to the requirements of Solvency II must take into consideration the features of their investment portfolios,

#### Definition

### Search for yield

BaFin's objective in investigating the search for yield on the part of insurers is to find out if undertakings are adopting more risky investment strategies for this purpose. This is to be expected in particular in times of low interest rates. The advantage of generating extra yield goes hand-in-hand with investment risks, which include more frequent defaults due to lower

debtor creditworthiness, a lack of experience with the new investment products, reduced liquidity and longer maturities. From a supervisory viewpoint, the search for yield becomes problematic when an undertaking finds itself incapable of adequately managing increased risk.

56 [https://eiopa.europa.eu/Publications/Reports/Investment\\_behaviour\\_report.pdf](https://eiopa.europa.eu/Publications/Reports/Investment_behaviour_report.pdf).

57 See BaFinJournal December 2017, page 23 (only available in German).

58 See also BaFinJournal November 2017, page 23 ff. (only available in German).

59 Directive 2014/95/EU, OJ EU L 330/1.

including sustainability, for the purposes of the regular review of their investment principles in accordance with EIOPA Guideline 29<sup>60</sup> on system of governance.

### **IORP II Directive**

The IORP II Directive<sup>61</sup>, which came into effect in January 2017, provides that the member states shall allow institutions for occupational retirement provision to take into account the potential long-term effects of their investment decisions on environmental and social factors as well as on factors relating to corporate governance.

Article 30 of the IORP II Directive enables the member states to ensure that IORPs prepare a written statement of those principles of their investment policies that take account of environmental, social and governance factors.

### **Implementation of sustainability in practice**

Supervisory discussions between BaFin and individual undertakings show how insurers deal with the topic of sustainability in practice: in the third quarter of 2017, for example, a number of undertakings demonstrated the importance attached to ESG criteria in their investments. In some cases, the undertakings presented comprehensive processes for integrating sustainability criteria.

#### **2.4.4 Bail-ins**

As of 1 January 2017 unsecured debt instruments may also be used in the event of insolvency, ranking directly after the owners' equity. The basis for this is a tool for involving creditors in sharing losses known as a "bail-in".<sup>62</sup>

This issue is of great importance for the insurance sector. Most German insurers and IORPs are invested in bank securities, in particular in equities, *Pfandbriefe* and unsecured debt instruments. Investment in unsecured debt instruments issued by banks in recent years has been in the high tens of billions. Insurers therefore need to deal with the new regulatory environment and the associated risks in the context of the supervisory requirements. This need is reinforced by the fact that individual credit institutions have got into financial difficulties in the recent past.

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60 EIOPA-BoS-14/253 EN.

61 Directive (EU) 2016/2341, OJ EU L 354/37, on the IORP Directive see also 1.3.

62 See BaFinJournal December 2015, page 22 ff. [www.bafin.de/dok/7874278](http://www.bafin.de/dok/7874278)

### **Own credit risk assessment**

Pursuant to section 28 (2) of the Insurance Supervision Act in conjunction with Article 5a(1) of the European Credit Rating Regulation<sup>63</sup>, insurance undertakings and institutions for occupational retirement provision must carry out their own credit risk assessments. They may not rely exclusively or automatically on external ratings for the purposes of assessing the creditworthiness of a company or a financial instrument. Against the background of continuing low interest rates and the associated poor yields, avoiding a credit default and thus preserving the nominal value is even more important for insurers. The own credit assessment therefore plays a decisive role in insurers' investment activities, independently of the statutory regulations. Some undertakings have already put in place extensive and complex rating procedures.

For the assessment of the credit risk of bank debt instruments, qualitative criteria must be addressed along with quantitative considerations such as balance sheet data. Insurers should also analyse the extent to which support measures resulting from statutory or voluntary deposit guarantee schemes are still in place. The credit institution's non-performing loans may also provide indications about its credit risk.

## **2.5 Developments in the individual insurance classes**

The following figures for 2017 are only preliminary. They are based on the interim reporting as at 31 December 2017.

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.<sup>64</sup>

### **2.5.1 Life insurers**

#### **Business trends**

New direct life insurance business in 2017 with approximately 4.9 million new policies remained just below the previous year's level of 5.0 million. At the same time, the total value of new policies underwritten rose slightly by 0.6 percent to around €265.8 billion compared with €264.2 billion in the previous year.

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

64 For the number of undertakings under supervision, see the Appendix, page 183.



The share of the total number of new policies accounted for by term insurance policies increased year on year from 34.1 percent to 35.4 percent.

The share attributable to pension and other insurance contracts declined marginally from 55.8 percent to 55.5 percent over the same period. The proportion of endowment life insurance policies also fell by 1.0 percentage points to 9.1 percent.

Early terminations of life insurance policies (surrender, conversion to paid-up policies and other forms of early termination) recorded a small reduction from 2.3 million contracts in 2016 to 2.2 million contracts in the year under review. However, the total sum insured of policies terminated early rose slightly to €98.5 billion compared with €98.1 billion in the previous year.

There were a total of approximately 83.7 million direct life insurance contracts at the close of 2017, compared with 84.5 million in the previous year. By contrast, the sum insured increased by 2.9 percent to €3,102 billion. Term insurance policies recorded a marginal decrease in the number of contracts from 13.0 million to around 12.9 million, although the sum insured rose significantly from €781.4 billion to €827.9 billion. Pension and other insurance policies continued the positive trend of recent years, with the number of contracts growing from 52.6 percent to 54.4 percent as a proportion of the total. The share of the total sum insured rose from 54.5 percent to around 55.6 percent.

Gross premiums written in the direct insurance business of the German life insurers remained almost unchanged at €85.6 billion in the year under review (previous year: €85.7 billion).

### Investments

Aggregate investments increased in the year under review by 2.7 percent from €882.6 billion to

€906.1 billion. In particular, since the level of interest rates on the capital market recovered slightly, net hidden reserves at the year-end declined to €132.6 billion compared with €152.5 billion in the previous year. This corresponds to 14.6 percent of the aggregate investments, following 17.2 percent in the previous year.

Preliminary figures put the average net investment return at 4.4 percent in 2017, the same level as in the previous year. One reason for the high net return could be that the insurers have again realised valuation reserves in order to fund the high cost of establishing the *Zinszusatzreserve*.

### Projections

BaFin again prepared projections for the life insurers in 2017. BaFin uses the projections primarily to analyse how two 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 to medium term. However, should interest rates remain low, it is to be expected that the economic position of the undertakings will deteriorate. 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.

### Solvency II

For the purpose of calculating the solvency capital requirement (SCR) at the close of 2017, a total of 73 of the 84 life insurers under BaFin's supervision employed the standard formula while 11 undertakings used a

#### Note

### Life insurance projections

The projection as at the 30 September 2017 reference date focussed on examining the medium- to long-term impact of the low level of interest rates on the life insurers. For this purpose, BaFin collected data on the forecast financial performance in accordance with the German Commercial Code (*Handelsgesetzbuch*) for the 2017 financial year and the following 14

financial years. For this purpose, BaFin assumed that new investments and reinvestments were made solely in fixed-interest securities with a 10-year maturity and an interest rate of 1.2 percent. The undertakings were also required to simulate the impact of a 100 basis points rise in interest rates on the profit or loss for the current year and on the following two financial years.

partial internal model. None of the life insurers used undertaking-specific parameters.

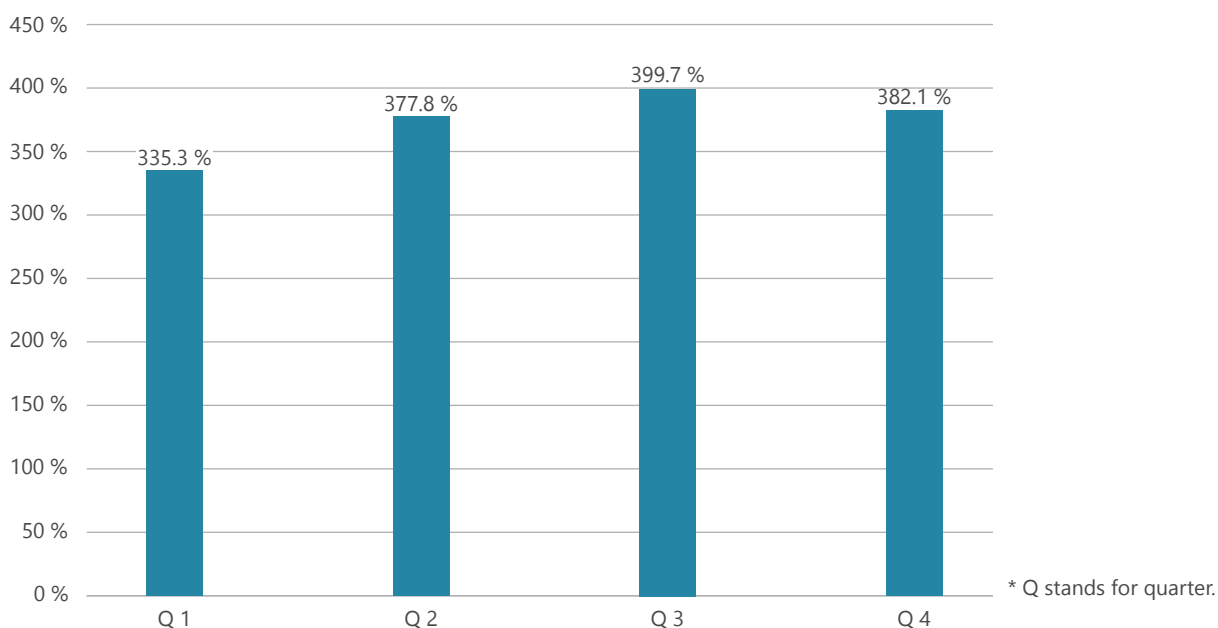
Of the total of 84 life insurers, 45 applied the volatility adjustment in accordance with section 82 of the Insurance Supervision Act and the transitional measure for technical provisions pursuant to section 352 of the Insurance Supervision Act. 14 life insurers used only the transitional measure for technical provisions, while 9 undertakings employed the volatility adjustment as the only measure. 1 undertaking applied the transitional measure for risk-free interest rates pursuant to section 351 of the Insurance Supervision Act, i.e. the transitional discount curve, in combination with the volatility adjustment. In total, therefore, 55 life insurers used the volatility adjustment, 59 life insurers the transitional measure for technical provisions and 1 life insurer the transitional discount curve.

### SCR coverage

All of the life insurance undertakings were able to report adequate SCR coverage as at 31 December 2017. The SCR ratio of the undertakings not exempted from elements of interim (quarterly) reporting pursuant to section 45 of the Insurance Supervision Act (eligible own funds of the sector in relation to the SCR of the sector) amounted to 382.1 percent compared with 316.3 percent in the previous year.

Figure 4 (“Development of SCR coverage ratios”) shows the SCR coverage ratios of the life insurance undertakings subject to interim reporting obligations over time.

**Figure 4: Development of SCR coverage ratios**



### Composition of the SCR

As at 31 December 2017, the SCR of the life insurance undertakings subject to interim reporting obligations declined to €31.7 billion compared with €36.0 billion in the previous year. Measured by the gross basic SCR, 76 percent on average of the capital requirements of the undertakings applying the standard formula in 2016 was attributable to market risk (excluding diversification effects). In addition, a significant proportion of the SCR related to underwriting risks for life (29 percent) and health (21 percent) insurance. By contrast, counterparty default risks (2 percent) were generally less important. The percentages quoted add up to more than 100 percent because diversification effects, which reduced the gross basic SCR, have not yet been included. They amounted to 28 percent.

The SCR required to be covered is calculated on the basis of the gross basic SCR, taking other variables into account. In this context, the loss-absorbing effects of technical provision (65 percent) and deferred taxes (9 percent) reduced the figure, while operational risk (3 percent) resulted in a slight increase.

### Composition of own funds

The own funds eligible for the SCR of the life insurance undertakings subject to the interim reporting requirements amounted to €121.1 billion as at 31 December 2017. In the previous year, 98 percent of the eligible own funds were accounted for by basic own funds and 2 percent by ancillary own funds. 96 percent of the eligible own funds were attributable to the highest class of own funds (Tier 1) and the majority

of the remainder to the second-highest class (Tier 2). On average, the reconciliation reserve accounted for 64 percent of the industry's basic own funds, while surplus funds accounted for 29 percent. Other noteworthy components at the reporting date were share capital including issuing premiums (4 percent) and subordinated liabilities (3 percent).

### 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 on 31 December 2031.

### 27 insurers affected

Since the introduction of Solvency II, 27 life insurance undertakings have been required to submit a remediation plan because 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. The undertakings concerned are required to comment on the stage of development of the measures in the annual progress reports, even if adequate SCR coverage has been restored in the meantime without the application of transitional measures.

### 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 2018. 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 2.3 percent for the sector. This figure was 2.5 percent in 2017 and 2.8 percent in 2016.

### Development of the *Zinszusatzreserve*

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 2017 was well over € 15.0 billion. The cumulative ZZR

at the end of 2017 therefore amounted to € 59.5 billion. The reference interest rate used to calculate the ZZR was 2.21 percent at the end of 2017.

The expectation is that the undertakings will continue to incur a substantial expense for the next few years to build up the ZZR. BaFin is therefore monitoring future developments at the level of the industry as a whole and of the individual undertakings very closely.<sup>65</sup>

## 2.5.2 Private health insurers

### Business trends

The 46 private health insurers supervised by BaFin generated premium income totalling around € 39 billion in 2017. This represents an increase of 4.8 percent over 2016. The growth in premiums was therefore higher than in the previous year. The growth in premiums was due firstly to the fact that there was no further erosion of the portfolio as seen in recent years. It was also attributable to new business, especially in supplementary insurance, and to premium adjustments.

Comprehensive health insurance, with around 8.8 million persons insured and premium income of € 27 billion – representing 70 percent of total premium income – continued to be the most important business line by far for the private health insurers in 2017. Including 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 41.4 million people.

### Investments

The health insurers increased the carrying amount of their investment portfolio by 4.9 percent to approximately € 273 billion in the year under review. Investment remained focused on fixed-income securities. BaFin did not identify any significant shifts between the asset classes.

The main macroeconomic factor affecting private health insurers is still the low interest rate environment. During the year under review, interest rates did rise slightly but they remain at an extremely low level. The health insurers' reserve situation remains comfortable, especially in light of high valuation reserves in fixed-income securities. At 31 December 2017, net hidden reserves in investments amounted to around € 41 billion,

<sup>65</sup> On the calibration of the *Zinszusatzreserve*, see also chapter I 7.2.

or roughly 15 percent of investments (previous year: 17 percent).

Preliminary figures put the average net investment return in the year under review at around 3.5 percent, and therefore below the level of the previous year (3.7 percent).

### Solvency

Since Solvency II came into effect on 1 January 2016, Solvency I has applied only to six health insurers qualifying as small insurance undertakings within the meaning of section 211 of the Insurance Supervision Act. Preliminary figures indicate that all six undertakings will comply with the solvency rules applicable to them as at 31 December 2017.

The remaining 40 health insurers were subject to the Solvency II reporting obligations at the end of 2017. The majority of these health insurers apply the standard formula to calculate the SCR. Four undertakings use a partial or full internal model. None of the undertakings used undertaking-specific parameters.

### Transitional measures

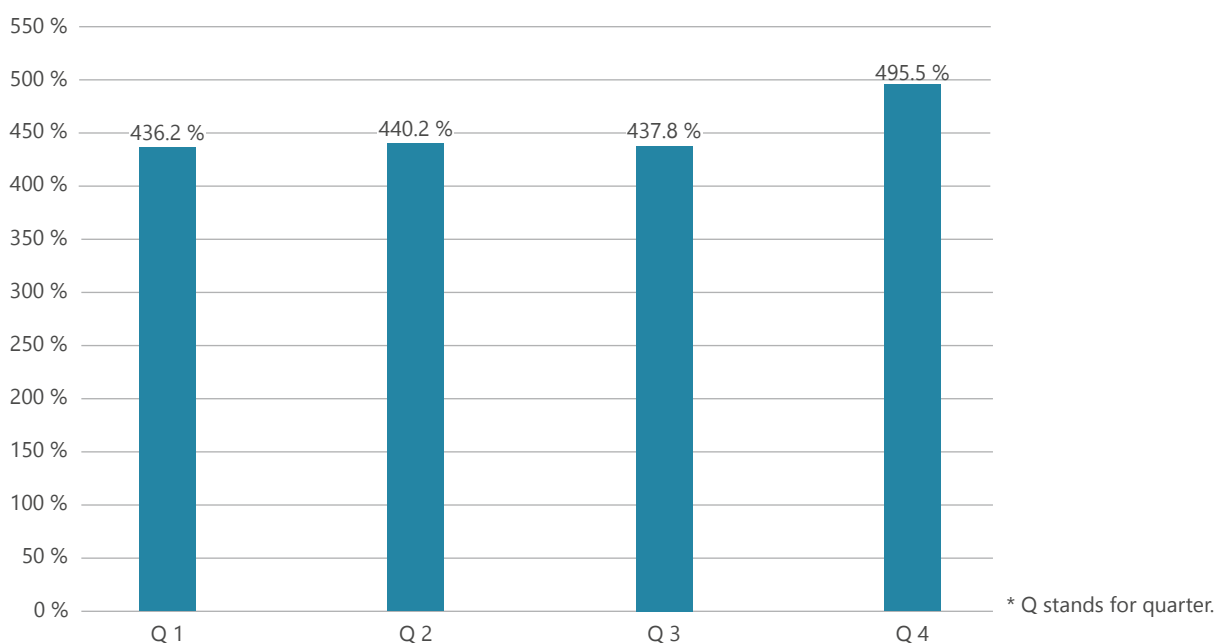
In the year under review, one health insurer applied the volatility adjustment in accordance with section 82 of the Insurance Supervision Act and the transitional measure for technical provisions pursuant to section 352 of the

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 discount curve, i.e. 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 report a shortfall without that measure must submit a remediation plan in accordance with section 353 (2) of the Insurance Supervision Act. None of the health insurers has so far been required to submit a remediation plan of that type.

All of the undertakings demonstrated more than adequate coverage of the SCR at 31 December 2017 – as well as at all the quarterly reporting dates in 2017. Figure 5 “Development of SCR coverage ratios” shows the SCR coverage ratios of the sector.

As at 31 December 2016, the SCR coverage ratio amounted to 432 percent.<sup>66</sup> Only a limited comparison can be made between this figure and the data for the quarterly reporting dates, however, 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 are mainly caused by changes in the interest rate environment and in own funds, in particular the surplus funds.

**Figure 5: Development of SCR-coverage ratios**



<sup>66</sup> Year-end figure.

The sector SCR for all private health insurers subject to interim reporting obligations amounted to €5.5 billion as at 31 December 2017. The health insurers are primarily exposed to market risk. This was responsible for around 78 percent of the capital requirements for users of the standard formula at the close of the previous year. Around 41 percent of the capital requirements at that date related to the underwriting risk for health insurance.

The eligible own funds for all health insurers subject to interim reporting obligations amounted to approximately €27.2 billion as at 31 December 2017. The health insurers report the majority of their own funds in the reconciliation reserve. At the end of the previous year, the proportion was approximately two-thirds. The surplus funds are another major component of own funds, accounting for around one-third. Other own-fund items such as share capital including the attributable issuing premium were comparatively unimportant.

### Projections

BaFin also carried out a projection exercise for health insurers in 2017 in order to simulate the effects of unfavourable developments in the capital market on their performance and financial stability (see info box "Health insurance projections").

38 insurers took part in the projection exercise. Only nine undertakings were exempted from taking part by BaFin.<sup>67</sup> These were mainly insurers offering Non-SLT health insurance. These undertakings 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 point of view. As expected, the data generated show that in a low interest rate scenario the risk attaching to new investments and reinvestments continues to arise and that investment returns decline. This demonstrates that the technical interest rate must be gradually brought down by means of premium adjustments.

### ACIR and technical interest rate

The health insurers base the determination of the technical interest rate on the actuarial corporate interest rate (ACIR) (see info box "Actuarial corporate interest rate" on page 118).

The ACIR figures calculated in the 2017 financial year are below the maximum technical interest rate of 3.5 percent stipulated in the German 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 continuing 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.

### Revision of ACIR procedure

The Board of the DAV approved a revised version of the ACIR guideline on 27 November 2017. It replaces the guideline of the same name dated July 2012 and applies for the first time to the calculation of the ACIR in April 2018. Calculations dated prior to that date and which have already received consent from the trustee are not affected by the new directive.

#### Note

### Health insurance projections

The projection as at the 30 September 2017 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 forecast financial performance in accordance with HGB for the 2017 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 1.2 percent. In a second scenario, the health insurers could simulate new investments and reinvestments according to their individual corporate planning.

<sup>67</sup> 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 this chapter.

## 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. 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 Association of Actuaries (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.

The purpose of the revised guideline, as before, is to establish an appropriate procedure for reviewing the maximum technical interest rate set for a private health insurance undertaking from an actuarial point of view. For the actuaries, a procedure is set out for reviewing the sustainable long-term return an individual health insurance undertaking is capable of achieving. A method is also demonstrated whereby the responsible actuary and the actuarial trustee involved in the premium adjustment can determine an appropriate and reliable technical interest rate for the entity under consideration (in accordance with the guideline *“Aktuarielle Festlegung eines angemessenen Rechnungszinses für eine Beobachtungseinheit”* published by the DAV in 2016).

Around half of insureds are affected by the premium adjustments for comprehensive health insurance pending in 2018. The average premium adjustment for the sector amounts to approximately 6.8 percent. The health insurers have used a total of approximately €2.1 billion of the provisions for bonuses to limit the increases in premiums.

### 2.5.3 Property and casualty insurers

#### Business trends

Property and casualty insurers recorded a 6.9 percent year-on-year increase in gross premiums written in the direct insurance business in 2017 to €76.0 billion (previous year: €71.0 billion). This above-average increase – in comparison to earlier years – was the result of two special factors. Firstly, the calculations included the new authorisation of a larger insurance undertaking for the first time. Secondly, one insurer experienced a significant rise in premiums. Excluding these two special items, the 3.1 percent growth in premiums for all property and casualty insurers was slightly above the previous year's level.

Gross expenditures for claims relating to the year under review rose by 5.5 percent to €24.4 billion (previous year: €23.1 billion). Gross expenditures for claims relating to prior years also rose by 5.5 percent to €18.9 billion. Provisions recognised for individual claims relating to the year under review amounted to €21.1 billion, compared with €19.1 billion in the previous year; provisions recognised for individual claims relating to prior years amounted in total to €63.5 billion, compared with €58.3 billion in the previous year.

#### Motor vehicle insurance

With gross premiums written amounting to €27.5 billion, motor vehicle insurance was by far the largest insurance class. This represented growth of 8 percent 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 7.3 percent year on year, while gross expenditures for claims relating to previous years were up 10.7 percent. Overall, gross provisions recognised for individual claims relating to the year under review were higher by 17.5 percent year on year, while they increased by 7.8 percent for outstanding claims relating to 2016.

#### General liability insurance

Property and casualty insurers collected premiums of €9.8 billion (+3.9 percent) for general liability insurance. Claims relating to the year under review rose by 4.0 percent in comparison with the previous year to €1.0 billion. Property and casualty insurers paid out €3.1 billion for claims relating to prior years (previous year: €3.2 billion). Gross provisions for individual claims, which are particularly important in this insurance class, rose by 7.8 percent to €3.2 billion for outstanding claims relating to the year under review. Gross provisions for

outstanding individual claims relating to prior years rose by 9.7 percent to €20.4 billion.

### Fire insurance

Insurers recorded gross fire insurance premiums written of €2.3 billion (+7.6 percent). Gross expenditures for claims relating to the year under review fell sharply by 13.9 percent to €491.9 million.

### Residential buildings and contents insurance

Insurers collected premiums for comprehensive residential buildings insurance and comprehensive contents insurance contracts of €10.1 billion (+5.6 percent). Expenditures for claims relating to the year under review grew by 1.8 percent year on year. Gross provisions recognised for individual claims relating to the year under review increased by 14.1 percent. Expenditures for claims relating to previous years increased by 4.1 percent. Provisions for claims relating to previous years rose by 8.5 percent.

### Accident insurance

Premium income for general accident insurance contracts amounted to €6.5 billion, the same level as in the previous year. Gross expenditures for claims relating to the year under review amounted to €431.5 million. €2.4 billion was reserved for outstanding claims relating to the year under review (+3.7 percent).

### Solvency I

The new Solvency II supervisory system came into force on 1 January 2016. Solvency I now only applies to around 11 percent of property and casualty insurers which constitute small insurance undertakings within the meaning of section 211 of the Insurance Supervision Act.

At 349 percent, the solvency margin ratio of German property and casualty insurers subject to Solvency I at the end of 2016<sup>68</sup> was significantly higher than the previous year's figure of 311 percent. The reason for the increase was the smaller population of property and casualty insurers still falling within the scope of Solvency I.

### Solvency II

As at 31 December 2017, 89 percent of property and casualty insurers were subject to supervision in accordance with Solvency II. 92 percent of all property and casualty insurers subject to reporting obligations under Solvency II used the standard formula to

determine their solvency capital requirement (SCR). Six insurance undertakings calculated the SCR on the basis of an internal model while nine used a partial 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.

All property and casualty insurers were able to report adequate SCR coverage as at 31 December 2017. The SCR coverage ratio for the industry amounted to 284 percent.

The SCR of the property and casualty insurers for 2017 was €34.6 billion. The minimum capital requirement (MCR) for the industry as a whole amounted to €11.5 billion. The most important risk drivers by far for property and casualty insurance were market risk and underwriting risk for non-life insurance. These represented 61 percent and 53 percent, respectively, of the basic solvency capital requirement. Underwriting risk for health insurance (7 percent) and counterparty default risk (4 percent) were much less significant. The diversification effect reducing the capital requirements amounted to 26 percent, while the loss-absorbing effects of deferred taxes represented 20 percent of the basic solvency capital requirement.

Those German property and casualty insurers falling within the scope of Solvency II had eligible own funds for the purposes of SCR coverage amounting in total to €98.3 billion as at 31 December 2017. Of total eligible own funds, around 98 percent were attributable to the highest category of own funds (Tier 1). The share of Tier 2 own funds was 2 percent. The property and casualty insurers report the majority of eligible own funds in the reconciliation reserve. As at 31 December 2017, this proportion was approximately 87 percent of basic own funds.

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. The undertakings are therefore considerably less sensitive and volatile in response to movements in the capital markets.

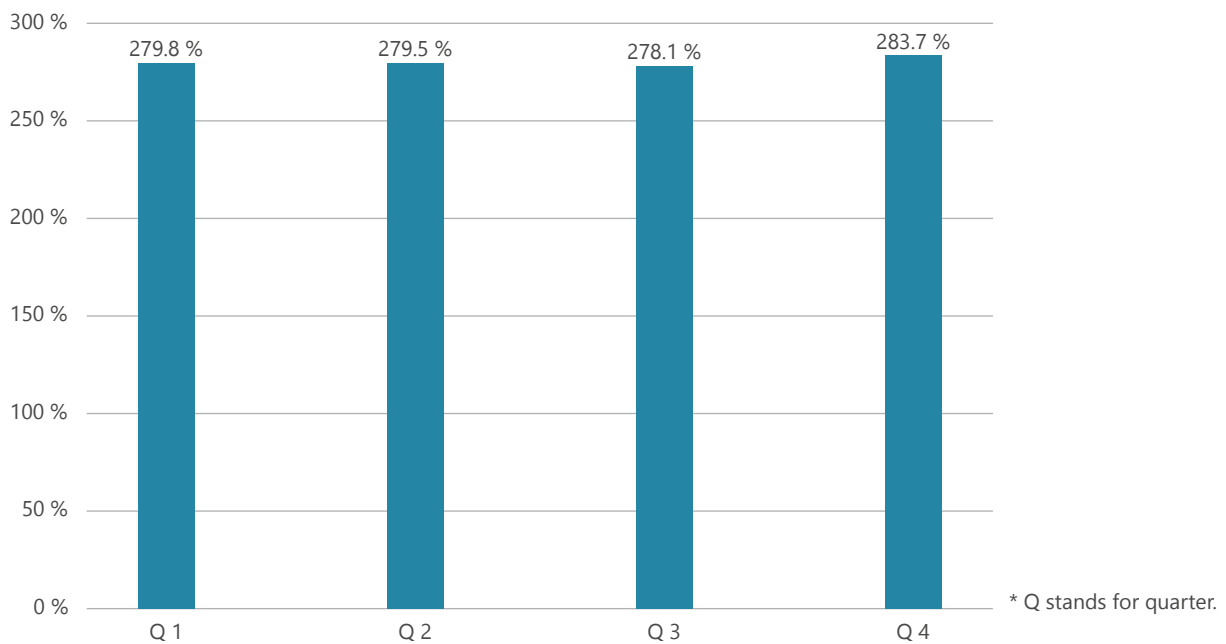
## 2.5.4 Reinsurers

### Business trends

Claims expenditures for the reinsurers in 2017 were significantly higher than the long-term average as a result of the hurricane season. Following 12 years in

<sup>68</sup> The disclosures relate to the 2016 financial year since projections are not prepared for property and casualty insurers.

**Figure 6: Development of SCR-coverage ratios**



which the US mainland had not been hit by a powerful hurricane, three hurricanes rated as category 4 and higher reached the United States at the same time in August and September. According to the estimates so far, Harvey, Irma and Maria caused insured losses amounting to around US\$92 billion in the United States and the Caribbean, which made the 2017 hurricane season the most costly since 2005 with Katrina, Wilma and Rita.

The full valuation of the insured losses has not yet been completed. The overall economic losses caused by Harvey, Irma and Maria, however, will significantly exceed the insured losses. This is because a large proportion of the flood damage caused by Harvey in Texas and the extended loss of power in Puerto Rico following Maria are uninsured as is the increase in prices following the repair of the damage.

Natural disasters are estimated to have caused total economic losses amounting to US\$ 330 billion worldwide in 2017. This amount was substantially higher than the previous year's figure of US\$ 184 billion and above the 10-year average of US\$ 170 billion.<sup>69</sup> Of the total economic losses from natural disasters in 2017, losses amounting to US\$ 135 billion were insured. This amount

also significantly exceeded the previous year's figure of US\$ 51 billion and the 10-year average of US\$ 49 billion. Over two-thirds of all insured losses were accounted for by hurricanes Harvey, Irma and Maria with US\$ 92 billion. Further significant losses were caused by forest fires in California and earthquakes in Mexico, which also occurred in the second half of the year.

The high level of losses in the second half of 2017 had a severe impact on the underwriting results of some reinsurers. The extent to which there will be a trend change in the reinsurance market in response is uncertain. Prices in the regions and lines of business affected by natural disasters will undoubtedly rise. But, in view of the quantity of excess capital looking for investment opportunities as a result of the low interest rate environment on the financial market, it is doubtful whether there will be sustainable price increases on a broad front. In the light of the oversupply of capacity, it seems likely that the soft market environment will continue after one or two rounds of renewals.

Developments in the alternative reinsurance market are also contributing to the pressure on prices. The inflow of alternative capital observed in the fourth quarter of 2017 at least made up for the collateral frozen as a consequence of the natural disasters. The alternative capital inflow does not seem likely to diminish over the long term.

<sup>69</sup> Munich Re: Press release 4 January 2018.



## Solvency II

Of the 33 German reinsurance undertakings subject to financial supervision by BaFin, 30 are required to comply with the Solvency II reporting obligations. They had own funds amounting to around €209.4 billion as at 31 December 2016 (previous year: €183.6 billion). At the same date, the solvency capital requirement (SCR) amounted to around €61.2 billion (previous year: €56.4 billion). This represented an average SCR coverage ratio of around 342 percent (previous year: 326 percent), slightly higher than the industry average (approximately 330 percent). The minimum capital requirement (MCR) coverage amounted to 981 percent on average at the reporting date (previous year: 930 percent).

The range of the coverage ratios within the reinsurance sector is considerable, especially with respect to the MCR. As at 31 December 2016, the reinsurers reported SCR coverage ratios between 70 percent and 550 percent, and MCR coverage ratios between 104 percent and 2,200 percent. Only one reinsurance undertaking reported inadequate capital coverage as at 31 December 2016, which was rectified in 2017.

### Heterogeneous market

The wide range of the coverage ratios reflects the heterogeneous nature of the reinsurance sector. In

addition to undertakings with regional and international operations, the sector also includes captive insurers, run-off platforms and some reinsurance undertakings that also perform the function of a holding company for an insurance group or a financial conglomerate (see info box "BaFin hosts an exchange of information on captives"). In such cases, the reinsurance activities are frequently subordinated to the holding company function and this is reflected, among other things, in more than adequate capital resources from the point of view of the reinsurance activities. Even though reinsurance undertakings represent only 8.8 percent of all insurers in terms of numbers, they nevertheless accounted for around 45.5 percent of the own funds of the entire insurance industry.

The average SCR coverage ratio declined by 6 percentage points to around 336 percent at the end of the fourth quarter of 2017. This was mainly due to the increase in the solvency capital requirement for one large reinsurance undertaking. Reinsurers with global activities together account for almost two-thirds of all technical provisions. The own funds of the reinsurance undertakings rose to a total of €212.2 billion as at 31 December 2017, while the solvency capital requirement recorded a small increase to €63.2 billion.

### Note

## BaFin hosts an exchange of information on captives

BaFin Chief Executive Director Dr Frank Grund and other insurance supervision experts met representatives of captive insurance undertakings in Bonn in March 2017 to exchange information. The 20 participants represented almost all of the German captives, including those of BASF, Siemens and Metro.

The discussions focused on the application of the proportionality principle under Solvency II. Under that principle, the regulatory requirements should be complied with in a manner which reflects the nature, scale and complexity of the risks of the individual undertaking. In comparison with large insurance undertakings, captives<sup>70</sup> represent a relatively low risk for the German insurance market as they are integrated into non-insurance groups

of companies. They insure risks that arise within the group itself and can normally be readily identified and monitored. Many representatives of captives are of the opinion that Solvency II does not take sufficient account of their particular business model. The proposed simplified requirements fall well short of their expectations. The captives are therefore keen to interpret the proportionality principle as widely as possible.

From BaFin's point of view, simplifications based on considerations of proportionality were possible, said BaFin Head of Division Ricarda Meier<sup>71</sup>: "Undertakings could be exempted from certain reporting obligations in particular cases if requested. But we must remain within the legal framework."

70 See BaFinJournal April 2017, page 25 f (only available in German).

71 See BaFinJournal April 2017, page 26 (only available in German).

## 2.5.5 *Pensionskassen*

### Business trends

According to the projection as at the 2017 reporting date, premium income for all *Pensionskassen* in 2017 rose year on year. Premiums earned amounted in total to approximately €7.4 billion in the year under review, a year-on-year increase of around 7.2 percent. In 2016, they had risen by 4.1 percent.

Premium income for the stock corporations newly formed since 2002, which offer their benefits to all employers, was slightly below the previous year's level at approximately €2.6 billion.

In the case of mutual associations (*Vereine auf Gegenseitigkeit*) funded largely by employers, premium income rose in comparison with the previous year. It amounted to around €4.7 billion, as compared with €4.2 billion in the previous year. The increase is attributable mainly to special contributions by employers.

### Investments

The aggregate investment portfolio of the *Pensionskassen* supervised by BaFin grew by 6.1 percent in 2017 to approximately €163.5 billion (previous year: €154.1 billion). The dominant investment types are still investment units, bearer bonds and other fixed-income securities, as well as registered bonds, notes receivable and loans.

Given that in 2017 interest rates once again remained 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 €23.7 billion at the end of the year (previous year: €23.9 billion). This corresponds to roughly 14.5 percent of the aggregate investments (previous year: 15.5 percent). The hidden liabilities were negligible at 0.4 percent overall.

### Projections and impact of the low interest rate environment

BaFin also prepared a projection for the *Pensionskassen* as at 30 September 2017. It asked the undertakings to estimate their results for the financial year under four equity and interest rate scenarios. In view of the continuing low interest rate environment, the projection also covered the four following financial years, as in the previous year.

As the projections demonstrated, the coverage ratio for the solvency capital requirement for the 2017 financial

year is around the previous year's level, although the *Pensionskassen* are not subject to the new Solvency II framework. 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 percent in 2017, the same as in the previous year.

The persistently low interest rates are also posing particular challenges for the *Pensionskassen*. The projections reveal clearly that the gap between the current return on investments and the average technical interest rate for the premium reserve is narrowing. If it should be necessary for individual *Pensionskassen* to reinforce their biometric actuarial assumptions or reduce the technical interest rate, it will become increasingly difficult for these *Pensionskassen* to finance the necessary increases in reserves from surpluses.

The results of the most recent EIOPA stress test have confirmed that the low level of interest rates has represented a particular burden for the *Pensionskassen* (see info box "*Pensionskassen and Pensionsfonds in the EIOPA stress test*" on page 123). BaFin therefore continues to monitor and support the *Pensionskassen* closely so that they can maintain and strengthen their risk-bearing capacity as far 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 2017 projection: in almost all cases, the *Pensionskassen* recognised additional provisions. However, it is becoming clear that if the low interest rate environment persists, certain *Pensionskassen* will require additional funds from third parties. 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 German Occupational Pensions Act (*Betriebsrentengesetz*). This gives the beneficiaries and pensioners additional security.

## **Pensionskassen and Pensionsfonds in the EIOPA stress test**

In 2017, EIOPA carried out the second Europe-wide stress test for institutions for occupational retirement provision (IORPs). EIOPA's target market coverage of 50 percent was achieved in Germany with the participation of a selection of *Pensionskassen* and *Pensionsfonds* representative of the German market. The aim of the stress test was to determine the resilience of the European IORP sector in the light of possible negative developments on the capital market. For this purpose, a capital market scenario was assumed in which falling risk-free interest rates resulted in an increase in the economic value of the obligations, while at the same time the value of the IORPs' investments was in decline. EIOPA also addressed possible indirect effects of these developments on those employers using IORPs for occupational retirement provision in the form of defined benefit schemes.

In its stress test report, EIOPA indicates that those European IORPs offering defined benefit schemes would not have sufficient investments on an aggregated basis to be able to cover their obligations to the beneficiaries. For some of the employers using IORPs for the purpose of their employees' occupational retirement provision, there could be negative consequences if they had to make up those shortfalls.

The stress test included both defined benefit and defined contribution schemes. In the case of defined benefit schemes, the employees are guaranteed a specific benefit, as described above. For defined contribution schemes, the employer only guarantees to bear the cost of a specific contribution towards the occupational retirement provision of the employee. Since pure defined contribution schemes have only been permitted in Germany since

1 January 2018, German IORPs only participated in the element of the stress test relating to defined benefit schemes.

The stress test was conducted firstly on the basis of national valuation standards – and therefore in Germany on the basis of the IORPs' HGB balance sheets – and secondly on the basis of a standardised European common balance sheet (CBS) valuation approach.

For the purposes of the CBS approach, assets and liabilities were measured in line with market values. The technical provisions were calculated using risk-free interest rates. Security mechanisms, such as commitments by the employer to make additional payments or protection by the pension security association (*Pensions-Sicherungs-Verein*), were measured as assets in the context of the CBS approach. If the liabilities would otherwise have exceeded the available assets including security mechanisms, the value of the technical provisions was reduced until the value of the liabilities agreed with the value of the assets.

Corresponding reductions in liabilities or positive values of security mechanisms as assets indicate that security mechanisms could actually be used in the future or that benefits could be reduced. However, this depends in particular on possible countermeasures.

The results of the stress tests confirm BaFin's estimation that a continuation of the low interest rate environment would represent a major challenge for the IORPs. This would be even more the case for the scenario used in the stress test of a negative development of the capital markets.

### **Solvency**

According to the projection as at the 2017 reporting date, the solvency margin ratio in accordance with the German Capital Resources Regulation (*Kapitalausstattungs-Verordnung*) applicable to the *Pensionskassen* was an average of 131 percent, roughly the same level as in the previous year. Three *Pensionskassen* were unable to meet the solvency capital requirement in full as at 31 December 2017, according to the estimates. In these circumstances, *Pensionskassen* are

required to take steps to ensure that they comply with the own funds requirements again.

### **2.5.6 Pensionsfonds**

#### **Business trends**

*Pensionsfonds* recorded gross premium income of €2.4 billion in 2017. The figure for the previous year was €2.7 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 942,782 persons compared with 924,074 persons in the previous year. Of those, 596,923 were vested employees who were members of defined contribution pension plans, while 55,385 vested employees were members of defined benefit pension plans. The payouts were made to 291,165 persons who drew benefits.

### Investments

Investments for the account and at the risk of *Pensionsfonds* grew from €2,440 million to €2,690 million in the year under review. This corresponds to an increase in investments of 10 percent (previous year: 11 percent). *Pensionsfonds* portfolios were dominated by contracts with life insurers, bearer bonds, other fixed-income securities and investment units. As at 31 December 2017, net unrealised gains in the investments made by *Pensionsfonds* amounted in total to approximately €139.5 million (previous year: €168.1 million).

Assets administered for the account and at the risk of employees and employers grew only slightly in the year under review, from approximately €31.7 billion in the previous year to €34.2 billion. Roughly 91 percent of these investments, which are measured in accordance with section 341 (4) HGB at current market value, consisted of investment units.

### Projections and impact of the low interest rate environment

BaFin prepared projections in 2017 for 29 *Pensionsfonds* (see info box "Projections for *Pensionsfonds*). 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 technical provisions for the account and at the risk of employees and employers are generally recognised retrospectively in accordance with the assets administered for the account and at the risk of employees and employers. If this process indicates that the amount of the investments falls short of a minimum premium reserve which may be calculated on a prospective basis, the difference must be made up by supplementary contributions from the employer. The

projections showed that supplementary contributions had become due as at 31 December 2017 for two *Pensionsfonds*. This ensures that cover for these technical provisions recognised in the financial statements is guaranteed at all times.

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 even longer. As part of the projection exercise, the *Pensionsfonds* were therefore also asked to estimate the expenses for the *Zinszusatzreserve* (additional interest provision) over the next four financial years. They also had to indicate whether they expected to be able to cover the expenses with corresponding income, and whether they would be able to comply with the solvency requirements in accordance with the German Regulation on the Supervision of *Pensionsfonds* (*Pensionsfonds-Aufsichtsverordnung*) in the future as well. Of 21 *Pensionsfonds* which operate insurance-based business, 18 have so far been required to establish a *Zinszusatzreserve*. These 18 *Pensionsfonds* are currently financed through congruent reinsurance cover, or through current income or surpluses.

A number of *Pensionsfonds* also participated in the EIOPA stress test for IORPs (see info box "Pensionskassen and *Pensionsfonds* in the EIOPA stress test" on page 123). The results indicate that a persistent low interest rate environment could generate additional financial burdens for the employers, who may have to pay supplementary contributions to the *Pensionsfonds*.

#### Note

### Projections for *Pensionsfonds*

The scenarios defined by BaFin for the projections for the *Pensionsfonds* were the capital market situation at the 30 September 2017 reference date and a negative equity scenario with a 29 percent drop in prices. In addition, BaFin required scenarios to be calculated that combined each of the two above-mentioned scenarios with a 100 basis point increase in the yield curve.

### **Solvency**

According to the preliminary figures, 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

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# 1 Bases of supervision

## 1.1 MiFID II and MiFIR

### 1.1.1 Greater transparency and greater investor protection

**T**he issues that shaped the year 2017 included the implementation of MiFID II, the European Union's second Markets in Financial Instruments Directive<sup>1</sup>, whose provisions have been in force since 3 January 2018. The amendments are aimed at improving the functioning and transparency of the financial markets and providing better protection to consumers in the European Union (EU).<sup>2</sup> German legislators transposed MiFID II by way of the German Second Act Amending Financial Markets Regulations (*Zweites Finanzmarktnovellierungsgesetz*).

MiFID II assigns a number of new responsibilities to securities supervision, such as the authorisation and supervision of organised trading facilities (OTFs). These types of trading platforms were not regulated before.

<sup>1</sup> OJ EU L 173/349.

<sup>2</sup> See chapter I 5 on consumer protection and chapter II 2.

In addition, positions in commodity derivatives will become more transparent. Market participants will in future have to disclose such positions if they exceed a defined level. The supervisory authorities will moreover also supervise data reporting services. The aim is to make market data – for example on transactions in financial instruments that have been completed – more transparent and provide such data more cost-effectively.

Apart from these market-related amendments, MiFID II also contains a number of rules to improve investor protection.

#### **Investor protection improved**

For example, MiFID II ensures that clients receive better information about the cost of financial services. Investment firms have to inform clients about the total cost of investing and its impact on the yield, broken down into product costs and service costs.

What is more, MiFID II promotes independent investment advice. The directive prohibits banks and other financial services providers that give independent investment advice from accepting inducements from third parties. The German Fee-Based Investment Advice Act (*Honoraranlageberatungsgesetz*), which entered into force at the beginning of August 2014, already contains rules to this effect. The prohibition in MiFID II also covers

remuneration that the issuer of a financial instrument pays to the undertaking as sales commission.

### **Identifying the target market**

Moreover, MiFID II specifies comprehensive EU-wide rules for the product approval process. The directive covers the entire value chain, from product provider to client, and specifies new guidance for the associated organisational requirements and conduct of business rules. The aim is to ensure that financial products are manufactured in such a way that they meet client needs. Issuers will therefore have to specify the target market, i.e. the clients, for which the product is intended, at the time of creating a product. To this end, issuers have to use certain criteria, such as client category (retail client, professional client), the clients' knowledge and experience, their financial situation and risk-bearing capacity, their risk tolerance, investment objectives and needs.

MiFID II requires the distributor to conduct a critical review of the target market specified by the manufacturer, narrow it down in respect of its client base, and implement it in its distribution practice. The reason for this is that manufacturers can often take account of the above criteria only in very general terms. These requirements are supplemented by product governance requirements, including after the distribution process.

German product manufacturers and their associations have used the new regulations as an opportunity to formulate a market standard, which creates a consistent basis for distribution in different business models and product universes of the German financial market.

### **Record-keeping requirements**

Clients will notice the changes introduced by MiFID II especially in relation to investment advice. Investment advice minutes are a thing of the past. They have been replaced with the statement on suitability, which has to present, among other things, how the advice has been tailored to the preferences, objectives and other characteristics of the retail investor. The agreement on the recommended transaction may only be entered into after the client has received the statement on suitability, unless the agreement has been entered into using distance communication, in which case exemptions apply.

The record-keeping requirements of investment firms do, however, cover more than the statement on suitability. If clients give an order to their adviser subsequent to receiving advice, the time and place of

the meeting, the individuals in attendance, the initiator of the meeting and information on the order itself have to be documented. Investment firms now also have to record external and internal electronic communication and telephone conversations relating to client orders (taping). Clients have to be informed of this in advance and may object to the conversation being recorded. If they do object, the undertaking must not provide the service through this channel. The records must be retained for a period of five years. Clients may demand that (copies of) the recordings are made available to them.

### **Employee qualification**

MiFID II also expands and harmonises the requirements for the qualifications of employees. New requirements in Germany relate to the knowledge and experience as well as the reliability of portfolio managers. Unlike investment advisers, they make independent investment decisions for clients and are authorised to dispose of client funds.

The existing reporting requirements remain unchanged, however. The only persons to be reported for inclusion in the Employee and Complaints Register will continue to be investment advisers, sales representatives and compliance officers.

### **MiFIR regulates product intervention**

MiFID II is complemented by the Markets in Financial Instruments Regulation (MiFIR). As a European regulation, MiFIR is directly applicable. It now gives national competent authorities throughout Europe the power to prohibit or restrict the marketing, distribution and sale of financial instruments. The European Securities and Markets Authority (ESMA) and the European Banking Authority (EBA) are now also authorised to do so in certain circumstances. In addition, the powers of intervention set out in MiFIR are complemented by the European PRIIPs Regulation<sup>3</sup>, which has been directly applicable since 1 January 2018. This regulation gives the European Insurance and Occupational Pensions Authority (EIOPA) and national competent authorities similar powers relating to certain insurance-based investment products, for example.

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<sup>3</sup> 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.



German legislators had introduced the right to product intervention in 2015 – by way of the German Retail Investor Protection Act (*Kleinanlegerschutzgesetz*). BaFin has already made use of this right by restricting the marketing, distribution and sale of contracts for difference (CFDs).<sup>4</sup> BaFin can continue to take intervention measures, although they will be put on a new legal basis as a result of MiFIR.

### 1.1.2 MaComp revised

BaFin has brought its Minimum Requirements for the Compliance Function (*Mindestanforderungen an die Compliance-Funktion – MaComp*) in line with MiFID II and published the new version in March 2018.<sup>5</sup> BaFin amended existing and added new modules, thus implementing ESMA's guidelines pursuant to Article 16 of the ESMA Regulation. The wording and contents of all modules have been adapted to the new legal bases in the German Securities Trading Act (*Wertpapierhandelsgesetz*) and in Commission Delegated Regulation (EU) 2017/565.

The module dealing with the lists of inducements and of inducement applications, which replaces the previous module AT 8.2, has been entirely rewritten by BaFin. The following amendments were made in particular:

- There will no longer be a sampling process for monitoring employee transactions (BT 2)<sup>6</sup>, because under Article 29(5b) of the Implementing Regulation investment firms will in future have to be informed about each personal transaction immediately. Investment firms that do not have a process for keeping copies or have not introduced a reporting or consent requirement will have to adapt their arrangements accordingly.
- The revised module BT 5 implements ESMA's product governance guidelines<sup>7</sup> of June 2017. The guidelines focus on a process that is consistent throughout the EU for determining the target market, which is the centrepiece of the requirements for the product approval process set out in MiFID II. The obligations to define the target market are addressed to both manufacturers and distributors. In addition to the above criteria for determining

the target market<sup>8</sup>, the product features also play a part. The more complex the product, the greater the detail required for defining the target market in order to prevent unsuitable target client groups from being targeted. Distributors have to specify the target market and define in this process in particular the service through which a certain product can be offered.

Manufacturers and distributors also have to define a distribution strategy. The guidelines also stipulate an exchange of information between the two parties in this context with regard to the client information which the distributor is required to have and the services through which the products can be distributed, before the concept developer defines the distribution strategy.

The compliance function must be involved in the product governance process and is obliged to inform senior management about the financial instruments designed and recommended by the investment firm, especially about the distribution strategy.

- The revised module BT 9 specifies that sliding commissions must be disclosed explicitly in the firm's policy on how it deals with conflicts of interest. The module is the result of work on the issue of sliding commissions carried out in 2017. BaFin found in this process that the sliding commission models use different approaches, some of which make it impossible to rule out conflicts of interest.
- MiFID II also expands and harmonises the requirements for the qualification of employees. New requirements in Germany relate to knowledge and experience as well as the reliability of portfolio managers and sales representatives. Unlike investment advisers, employees in portfolio management make independent investment decisions on behalf of clients and are authorised to dispose of client funds. Sales representatives are employees who inform clients about financial instruments, structured deposits, investment services or ancillary services. The existing reporting requirements remain unchanged, however. The only persons to be reported for inclusion in the Employee and Complaints Register will continue to be investment advisers, sales representatives and compliance officers. BT 11 deals with the qualifications of investment firm employees, implements the corresponding ESMA guidelines dating from 2015 and complements the provisions of the German WpHG Employee Reporting Regulation (*WpHG-Mitarbeiteranzeigeverordnung*). Using examples and other tools, BT 11 describes good

4 See chapters I 3 and II 2.

5 "Minimum Requirements for the Compliance Function and Additional Requirements Governing Rules of Conduct, Organisation and Transparency pursuant to sections 63 *et seq.* of the Securities Trading Act."

6 BT stands for *Besonderer Teil* (Special Section).

7 Guidelines on MiFID II product governance requirements.

8 See 1.1.1.

procedures with which investment firms can make sure for the long term that their employees meet the professional requirements and maintain their levels of qualification.

- BaFin plans to publish the modules on the suitability assessment and the requirements for remuneration systems as soon as ESMA has issued the relevant guidelines.

## 1.2 EMIR – amendments under discussion

The revision of the European Market Infrastructure Regulation (EMIR) made considerable progress in 2017 (see info box “EMIR”).<sup>9</sup> In May, the European Commission published two proposals for amending EMIR. The first proposal deals mainly with adjustments to the supervision of central counterparties that provide services for the EU market from a third country. These amendments are above all being discussed in connection with the impending Brexit (EMIR 2). The second proposal is aimed at making the rules for derivatives simpler and more efficient. Simplifications are to be created especially for smaller market participants. The backdrop to these efforts is the European Commission’s “Regulatory Fitness and Performance” (REFIT) programme, which is meant to ensure that EU legislation delivers results for citizens and businesses effectively and at minimum cost. On 11 December 2017, the Council published a common political direction for the proposed amendments triggered by the REFIT programme. The amendments proposed as part of EMIR 2 are, however, still being debated.

The main ways to simplify the existing EMIR regulations the European Commission has identified as part of the REFIT programme are outlined below.

### Reporting obligation

In the European Commission’s opinion, there is firstly a need to amend the reporting obligation for OTC contracts. In future, derivatives contracts will no longer be reported by all parties to the contract, but only by the central counterparty. If a contract involves a small non-financial counterparty<sup>10</sup> and a financial counterparty, it will in future be reported only by the financial counterparty – which reports on behalf of the non-financial counterparty as well.

<sup>9</sup> For details on EMIR, see the 2016 Annual Report, pages 172 ff.

<sup>10</sup> A non-financial counterparty is considered small, if it does not exceed the clearing threshold for OTC derivatives specified in Article 10(3) of EMIR.

### Definition

## EMIR

By way of the European Market Infrastructure Regulation (EMIR) adopted in 2012, European legislators introduced the requirement to clear standardised over-the-counter (OTC) derivatives through a central counterparty (CCP). These counterparties need authorisation and are subject to regulatory requirements. EMIR is the implementation of a respective commitment by the G20 countries dating from 2009. Experience gathered during the 2007/2008 financial crisis had shown that systemic risks can arise in the market for OTC derivatives.

Secondly, intragroup transactions are to be exempt from the reporting requirement, if one of the counterparties is a non-financial counterparty. Reporting on historical transactions will likewise no longer be required. These measures are aimed at significantly simplifying the reporting system.

Furthermore, it is being proposed that non-financial counterparties are required to clear only the asset classes for which they have breached the clearing threshold, and no longer all asset classes. Whether the threshold has been breached will, moreover, no longer be determined on an ongoing basis, but calculated once a year. In this way, the Commission intends to ease the burden on non-financial companies in particular, i.e. companies in the real economy. According to the proposal, they will no longer be required to monitor what are normally small derivatives positions on an ongoing basis.

### Financial counterparties

The proposal also introduces a clearing threshold for financial counterparties. This means that, if a financial counterparty does not exceed a specific gross nominal volume of OTC contracts, it will not be required to clear the OTC derivatives. Associated with that is a simplified requirement for undertakings whose derivatives business volume is very small, since the cost of meeting the requirements is fairly small relative to the volume traded.

The simplifications for these undertakings, which are not systemically important, are intended to prevent these companies from opting not to hedge relevant business risks for cost reasons.

The proposal also removes frontloading, i.e. the retrospective clearing obligation for contracts entered into after EMIR entered into force, but before the clearing obligation commenced.

### Suspension of clearing obligation

There are also plans that, in response to ESMA's proposal, the European Commission will in special circumstances have the option to temporarily suspend the clearing obligation for individual derivatives. This would make it possible to respond with greater flexibility to changes in the general conditions in the derivatives business or even to crisis situations.

The European Commission's proposals are now being discussed with the European Parliament. Once agreement has been reached, the amended regulations are expected to be adopted in the course of 2018.

## 1.3 Recovery and resolution planning for CCPs

The draft regulation published by the European Commission at the end of 2016 for the recovery and resolution of central counterparties comprises an obligation for CCPs to draw up recovery plans that take their specific business models into account (see info box "CCPs as risk factor").<sup>11</sup>

In addition, the draft contains provisions for the case that a recovery fails or cannot be implemented because of a risk to financial stability. To this end, the draft specifies how to close open positions and settle uncovered losses through the resolution process. Uncovered losses may arise from the default of clearing members, normally banks (default losses). They may, however, also arise from the operating business of the CCPs themselves, for example as a result of IT disruptions or errors in managing the collateral clearing members have to provide (non-default losses). In accordance with EMIR and the further-going recovery actions of the CCP regulatory frameworks, the clearing members are initially called upon to cover the losses, at least in the case of default losses. A number of provisions are still in dispute among the member states, despite the ongoing negotiations. A compromise for the entire text of the regulation has been proposed by the Estonian Presidency of the Council. The negotiations in the Council working group will continue in 2018. The final draft report of the European Parliament was published on 31 January 2018.

## 1.4 EU Prospectus Regulation

The EU Prospectus Regulation<sup>13</sup> entered into force on 20 July 2017. With few exceptions, the regulation will only apply from 21 July 2019. The regulation is aimed at ensuring that securities prospectuses are made simpler and more user-friendly to enable investors to make

### Note

#### CCPs as risk factor

The European Market Infrastructure Regulation (EMIR) has made the financial markets significantly more robust: OTC derivatives are now no longer cleared between banks, thus reducing the risk of contagion in the case of a bank's default. On the other hand, financial market participants have become much more dependent on CCPs. If a CCP defaults, this may damage the stability of the financial markets. In order to contain this risk, 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 recovery and resolution regime of the Bank Recovery and Resolution Directive

(BRRD) – implemented in Germany mainly by way of the Recovery and Resolution Act (*Sanierungs- und Abwicklungsgesetz*) – is only applicable to CCPs that are at the same time CRR credit institutions.<sup>12</sup> In addition, 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. In view of this fact, the EU Commission has developed rules for the recovery and resolution of CCPs.

<sup>11</sup> For details on CCPs, see 2.6.

<sup>12</sup> Credit institutions which satisfy the criteria in Article 4(1)(1) of the CRR.

<sup>13</sup> Regulation (EU) 2017/1129, OJ L 168, page 12.

informed investment decisions, while at the same time making it easier for companies to access the capital market.

The new provisions will allow more exemptions from the prospectus requirement for admitting shares of the same class to a regulated market by increasing the threshold from 10 to 20 percent. A universal registration document is intended to contain information on the organisation, business activities, financial condition, income and future prospects of issuers; a description of the securities and a summary may be added to turn the document into a prospectus. Through the universal registration documents, issuers can attain the status of frequent issuer and thus benefit from a reduction in the time it takes to approve the prospectus from 10 to 5 working days.

The Prospectus Regulation specifies rules for simplified disclosures for secondary issuances. For certain companies, whose securities have been admitted continuously to a regulated market or a special market segment for small and medium-sized enterprises (SMEs) – an SME growth market – for at least the last 18 months are subject to simplified requirements. A new type of prospectus is the EU Growth prospectus, which gives certain companies, such as SMEs, the opportunity to take advantage of reduced disclosure requirements. Improved presentation of the information in the prospectus is above all intended to strengthen investor protection. For example, issuers will in future not be allowed to overload prospectuses with risk factors that hide the risk factors relevant to the investor.

At the European level, a number of measures have been and are being taken to implement the Prospectus Regulation. ESMA has published three consultation papers containing draft technical advice on the format and content of the prospectus, on the EU Growth prospectus and on scrutiny and approval.

#### **Implementation of national regulatory scope**

Article 1(3) of the Prospectus Regulation specifies that offers of securities to the public with a total consideration in the EU of less than €1 million (calculated over a period of 12 months) are not subject to a prospectus requirement, although the member states may impose other disclosure requirements. In addition, Article 3(2) of the Prospectus Regulation allows member states from 21 July 2018 onwards to increase the threshold for the obligation to publish a prospectus at the national level to up to €8 million (also calculated over a 12-month period).

## 1.5 Implementation of the SFT Regulation

The EU Regulation on transparency of securities financing transactions and of reuse<sup>14</sup> (SFT Regulation) entered into force on 12 January 2016. This regulation mainly sets out provisions aimed at improving the transparency and monitoring of securities financing transactions, such as securities lending and repurchase transactions, and similar financing structures, which are widely used in both the banking sector and the “shadow banking sector”.

#### **Second Act Amending Financial Markets Regulations**

By way of the German Second Act Amending Financial Markets Regulations (*Zweites Finanzmarktnovellierungsgesetz*) of 23 June 2017<sup>15</sup>, legislators nominated BaFin as the competent authority within the meaning of the SFT Regulation. This act contains specific implementing rules and requirements relating to administrative fine criteria to enable BaFin to take any actions that are suitable and necessary for monitoring whether the provisions of the SFT Regulation and the delegated acts and regulatory technical standards of the European Commission adopted on the basis of this regulation are being complied with.

In the context of introducing the Second Act Amending Financial Markets Regulations, the provisions of the SFT Regulation concerning management companies and collective investment undertakings within the meaning of the German Investment Code (*Kapitalanlagegesetzbuch*) were adopted into the Investment Code. In particular, the transparency obligations to investors and the provisions on reporting requirements and safeguards were thus inserted into the Investment Code. The provisions of the SFT Regulation on administrative sanctions and other administrative actions were all laid down in the Securities Trading Act, and the Investment Code refers to the Securities Trading Act in this context where the provisions of Article 28 of the SFT Regulation are not applicable. Article 28 of the SFT Regulation specifies that sanctions and other measures established in accordance with the Directive on Undertakings for Collective Investment

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<sup>14</sup> Regulation (EU) 2015/2365 of 25 November 2015 on transparency of securities financing transactions and of reuse and amending Regulation (EU) No 648/2012 (Transparency of Securities Financing Transactions Regulation, SFT Regulation), OJ L 337/1.

<sup>15</sup> Second Act Amending Financial Market Regulations on the Basis of European Legal Acts (*Zweites Gesetz zur Novellierung von Finanzmarktvorschriften aufgrund europäischer Rechtsakte*), Federal Law Gazette I p. 1693.

in Transferable Securities (UCITS)<sup>16</sup> and the Alternative Investment Fund Managers (AIFM) Directive<sup>17</sup> are applicable to infringements of the transparency obligations of Articles 13 and 14 of the SFT Regulation.

### Reporting obligation

In addition, Article 4 of the SFT Regulation lays down a reporting obligation for securities financing transactions. However, the parties subject to the reporting obligation have to submit the report not to the competent authority, but to a registered trade repository. Even though the SFT Regulation entered into force on 12 January 2016, the reporting obligation will only come into effect in stages on subsequent dates. The implementation periods set out in Article 33 of the SFT Regulation will only commence once the legal acts specified there have been adopted.

The reporting obligation in Article 4 of the SFT Regulation requires first of all that at least one of the parties to the transaction is considered a counterparty. This is the case if the entity entering into the trade is a financial or non-financial counterparty. Financial counterparties are listed in the exhaustive catalogue of Article 3(3) of the SFT Regulation. The only prerequisite for a non-financial counterparty<sup>18</sup> is that it must be a company that has its registered office in the EU or one that operates through a branch in Europe. The reporting obligation in Article 4 of the SFT Regulation covers all securities financing transactions entered into, i.e. securities repurchase agreements, securities or commodity lending transactions, purchase/repurchase or sale/repurchase transactions and Lombard transactions. In addition, the obligation covers not only reports on the conclusion of such transactions, but also on any modification or termination, details of which must be reported by both parties no later than the following working day.

However, Article 4 of the SFT Regulation only describes the minimum information the reports to be submitted must contain. It does not provide any details, including of the design of the respective reporting fields. For this reason, Article 4(9) and (10) of the SFT Regulation specifies that ESMA, in cooperation with the European System of Central Banks (ESCB), should draft regulatory technical standards specifying the details

of the report content and format. ESMA presented the draft regulatory standards to the European Commission on 31 March 2017. They provide details on reporting standards and the reporting logic as well as the most important aspects of the structure of a report.

## 1.6 BaFin's WpHG Administrative Fine Guidelines II

BaFin has brought its administrative fine guidelines dating from 2013 in line with the provisions of the Transparency Directive II<sup>19</sup> and the Market Abuse Regulation (MAR)<sup>20</sup>. The amendments were published in February 2017.<sup>21</sup> BaFin uses a two-stage system to determine the amount of an administrative fine.

### Stage 1 – determining the applicable basis for imposing a fine

If a legal person is involved, BaFin first determines which basis for imposing the fine is to be used. Administrative fines can be imposed on the basis of an absolute maximum or on the basis of a revenue- or surplus-related maximum. The latter cannot be applied to natural persons.

### Stage 2 – setting the fine

The second stage involves setting the appropriate level of the fine, which is primarily based on the circumstances of the offence committed and the perpetrator. To this end, in step 1, BaFin initially determines the base amount of the fine on the basis of the issuer's market capitalisation and an assessment of the circumstances of the offence. The guidelines define six groups of issuers, depending on size, ranging from issuers with a market capitalisation of up to €10 million to issuers with a market capitalisation of more than €20 billion. The circumstances of the offence are classified as "mild", "moderate", "severe", "very severe" or "exceptionally severe". The last two categories, in particular, are used to capture non-typical cases with an increased level of culpability. This allows BaFin, if necessary, to impose a fine close to the applicable maximum in order to ensure the fine has a punishing effect.

Subsequently, in step 2, BaFin adjusts the base amount, if there are mitigating or aggravating circumstances. For example, a confession may have a mitigating

<sup>16</sup> Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS), OJ L 302/32.

<sup>17</sup> Directive 2011/61/EU on Alternative Investment Fund Managers, OJ L 174/1.

<sup>18</sup> See Article 3(4) of the SFT Regulation.

<sup>19</sup> Directive 2013/50/EU, OJ EU L 294/13.

<sup>20</sup> Regulation (EU) No 596/2014, OJ EU L 173/1.

<sup>21</sup> See [www.bafin.de/dok/8535194](http://www.bafin.de/dok/8535194) (only available in German). For details on administrative fines, see 7 and chapter II 6.

effect, while a previous violation of capital markets law punished by a fine may have an aggravating effect.

Lastly, in step 3, BaFin considers the financial circumstances of the party concerned. In view of the significantly expanded upper limits of administrative fines, this step in the adjustment process is increasingly gaining importance. A reduction in the amount of the fine by way of a settlement remains an option within the scope of the WpHG Administrative Fine Guidelines II.

## 2 Monitoring of market transparency and integrity

### 2.1 Market abuse analysis

In the year under review, BaFin analysed 811 transactions (previous year: 706) for indications of market manipulation and insider trading (see Figure 7 “Market abuse analyses”).

In 241 cases, BaFin found indications of market abuse. 181 of these cases (previous year: 103) related to market manipulation and 60 (previous year: 46) to insider trading.

Most of the analyses were again triggered by suspicious transaction reports. Their number had risen significantly in the previous year as a result of the introduction of the new provisions of the Market Abuse Regulation (MAR)

for reporting suspicious orders and transactions. This trend continued in 2017. BaFin received 2,830 reports (previous year: 1,274) from a total of 292 different parties subject to reporting obligations (see Figure 8 “Suspicious transaction and order reports” on page 135).

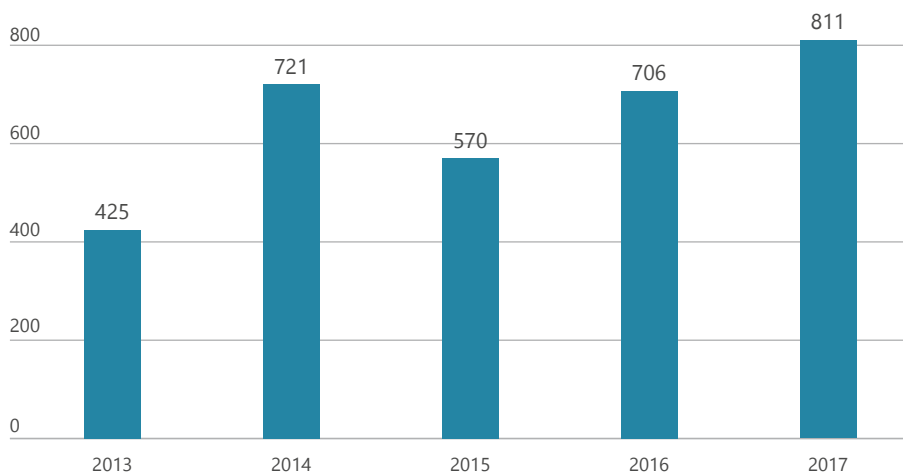
Driven especially by the large number of reports of trade-based market manipulation (in particular wash sales and pre-arranged trades), 2,467 of the reports were about alleged market manipulation and 344 related to suspected insider trading. There were 17 reports of possible violations of the prohibition on insider trading as well as the prohibition on market manipulation. 58 percent, and thus the vast majority of reports, related to market abuse involving equities, 20 percent affected warrants and certificates and 14 percent were attributable to bonds. They related to a total of 1,786 different financial instruments (previous year: 765).

In addition, BaFin again published 7 consumer warnings on its website in order to alert private market participants of market manipulation in the form of concerted manipulation attempts, such as phone calls or spam e-mails.

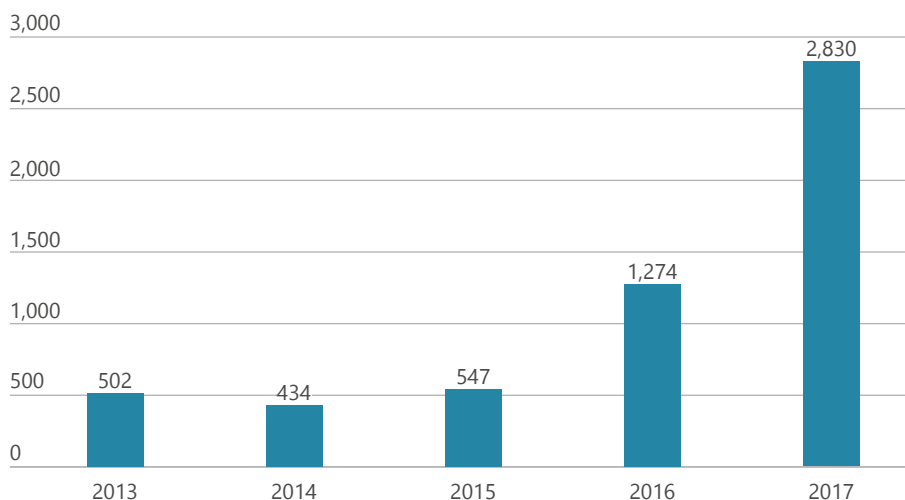
#### 2.1.1 Market manipulation analyses

149 of the total of 181 positive market manipulation analyses dealt with sham activities such as wash sales and pre-arranged trades (previous year: 81; see Figure 9 “Subject matter of positive market manipulation analyses” on page 135). In 24 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: 15).

**Figure 7: Market abuse analyses**



**Figure 8: Suspicious transaction and order reports**



Almost all other cases were based on manipulation of order situations or reference prices.

Broken down by stock exchange segment, 69 percent of the alleged cases of market manipulation were identified on the regulated unofficial market (*Freiverkehr*). The share attributable to this segment was thus virtually unchanged compared with the previous year (68 percent). Analyses relating to the regulated market accounted for 31 percent (previous year: 32 percent).

### 2.1.2 Insider trading analyses

The main focus of positive insider trading analyses – 20 cases – was on issues relating to companies’ earnings

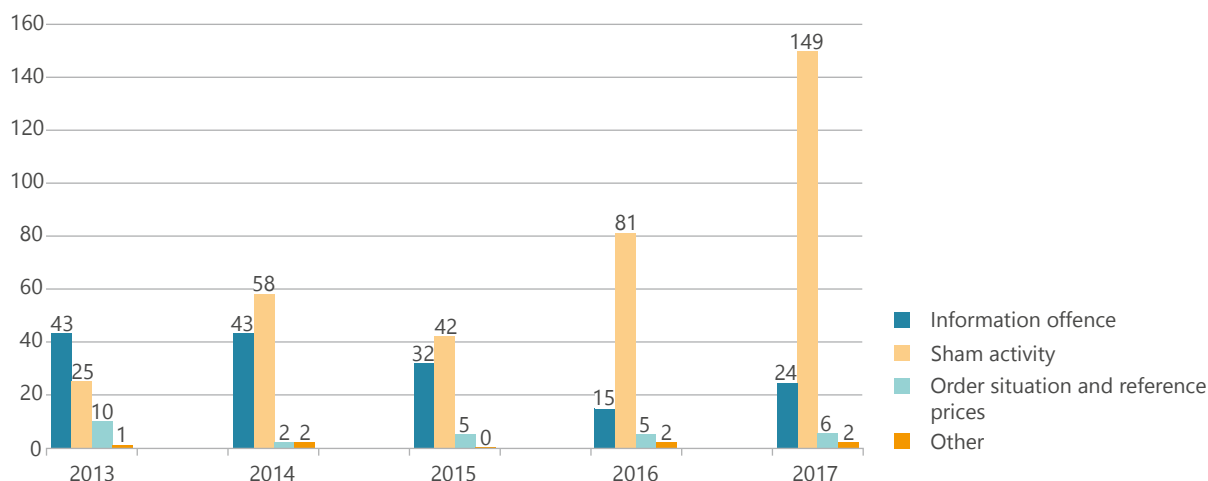
figures (previous year: 17; see Figure 10 “Subject matter of positive insider trading analyses” on page 136).

13 cases were recorded in connection with mergers and acquisitions (previous year: 10). As in previous years, most alleged insider trading took place on the regulated market (72 percent; previous year: 80 percent). The remaining cases (28 percent; previous year: 20 percent) related to the regulated unofficial market.

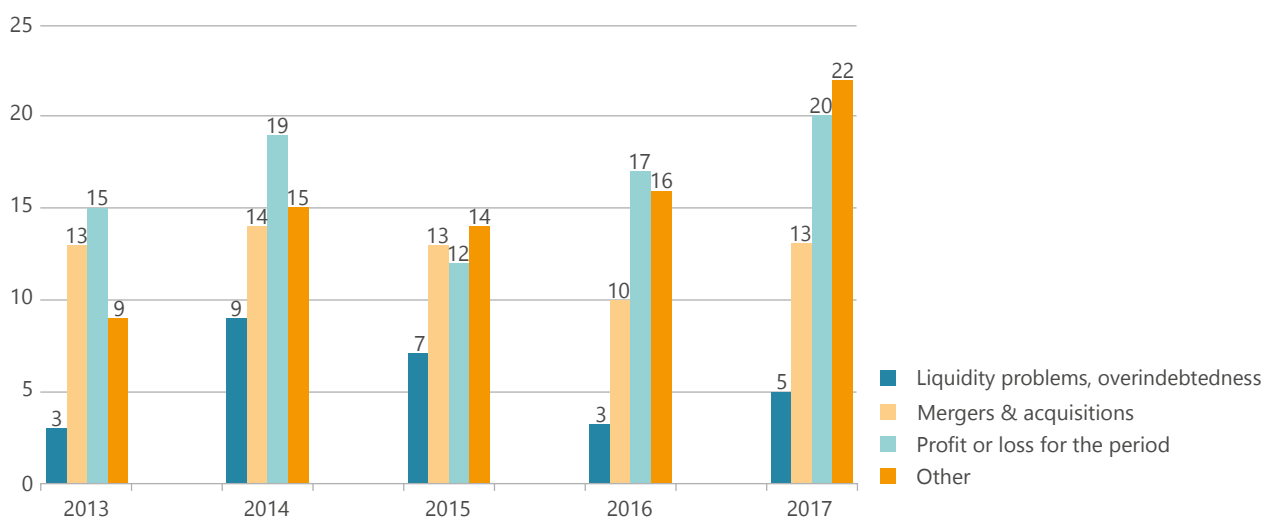
### 2.1.3 Recommendations and financial analyses

At the end of 2017, 392 credit and financial institutions that provide their customers with in-house recommendations or recommendations developed by

**Figure 9: Subject matter of positive market manipulation analyses**



**Figure 10: Subject matter of positive insider trading analyses**



third parties within the meaning of Article 20 of the Market Abuse Regulation were supervised by BaFin (previous year: 431). In addition, BaFin was notified of 236 independent natural or legal persons or associations of individuals that produced or disseminated recommendations (previous year: 213).

In addition to the Market Abuse Regulation, which has been in force since the middle of 2016, parties that produce and disseminate research material have, since 3 January 2018, also had to comply with the MiFID II Delegated Regulation, which sets out certain organisational requirements.<sup>22</sup> While the MiFID II Delegated Regulation continues to use the term “investment research”, the Market Abuse Regulation uses “investment recommendations”. Despite using different terms, they refer to the same thing in both cases. The use of different terminology led to a number of queries in the year under review. Both investment recommendations within the meaning of the Market Abuse Regulations and investment research within the meaning of the MiFID II Delegated Regulation are addressed to a wider group of recipients and are therefore unable to take individual targets and the risk appetite of an individual investor into account. They must therefore not be confused with the personal recommendations that investment advisors provide in the context of individual investment advice.

<sup>22</sup> See section 80 (1a) sentence 2 no. 2 of the Banking Act (*Kreditwesengesetz*) in conjunction with Article 37 of Delegated Regulation (EU) 2017/565.

## 2.2 Market manipulation

### 2.2.1 Investigations

The number of new market manipulation investigations launched in 2017 was virtually on a level with the previous year (see Table 19 “Market manipulation investigations” on page 137). The investigations concentrated mainly on trade-based manipulation. Another focal area was the investigation of “short attacks”. This refers to natural or legal persons entering into short positions in an issuer’s shares, for example, before then spreading negative reports on the issuer. The affected shares sometimes suffered price slumps of more than 30 percent within seconds of these reports being published. If specific conflicts of interest are not clearly pointed out in the reports published this is considered to be market manipulation.<sup>23</sup>

Again, more than half of the formal investigations launched were based on referrals by the trading surveillance units in 2017. Most of the other investigations were launched in response to positive market manipulation analyses and requests from public prosecutors’ offices and police authorities. There were significantly more requests than in 2016, especially from public prosecutors’ offices.

#### International cooperation

BaFin again worked together with foreign financial supervisory authorities on cases of market manipulation

<sup>23</sup> See BaFinJournal May 2017, pages 26 ff.



**Table 19: Market manipulation investigations**

Period	New investigations	Investigations discontinued	Investigation results					Ongoing investigations		
			Investigations referred to public prosecutors' offices or BaFin Administrative Fines Division						Total (cases)	Total
			Public prosecutors' offices		Administrative Fines Division*					
			Cases	Individuals	Cases	Individuals				
2015	256	44	160	290	10	14	<b>170</b>	<b>279</b>		
2016	272	40	106	275	7	9	<b>113</b>	<b>398</b>		
2017	226	56	121	197	6	7	<b>127</b>	<b>441</b>		

\* 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.

in 2017. BaFin involved the supervisory authorities of a total of 27 countries (previous year: 23) in 95 cases (previous year: 113). BaFin was asked for international administrative assistance in 44 cases (previous year: 42). The requests for administrative assistance submitted to BaFin came from supervisory authorities in a total of 13 countries (previous year: 14).

The main focus in 2017 was again on dialogue with the supervisory authorities of other EU member states, such as Austria and the United Kingdom, although BaFin also cooperated successfully with other countries, such as Singapore, Mauritius or the Bahamas. BaFin increasingly also exchanged information with the supervisory authorities in Hong Kong, Canada and the United States – especially on alleged market manipulation in connection with the dissemination of reports on the shares of smaller companies. With regard to these “pump and dump” schemes, BaFin was able to benefit from the findings and experience of its foreign colleagues. Especially when investigating these types of, usually complex, cases, it is necessary to cooperate promptly and efficiently with supervisory authorities around the world in order to pool information and, if necessary, coordinate a joint approach.

BaFin found evidence of punishable market manipulation in 121 cases completed in 2017 (previous year: 106). It filed complaints against 197 suspects with the relevant public prosecutor's office (previous year: 275). In 6 other cases (previous year: 7) involving a total of 7 persons (previous year: 9), there was evidence that an administrative offence had been committed. In 56 cases, the investigation did not find any evidence of violations (previous year: 40). The number of

investigations still pending at the end of 2017 was 441 (previous year: 398).

## 2.2.2 Sanctions

In 2017, 4 individuals were sentenced for market manipulation following a full public trial (previous year: 10) and 0 individuals were acquitted (previous year: 3; see Table 20 “Completed market manipulation proceedings” on page 138). Sentences were passed in 15 cases (previous year: 13).

The public prosecutors' offices discontinued a total of 373 investigations (previous year: 310). In 187 of these cases (previous year: 166), 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 24 investigations (previous year: 17) were provisionally discontinued in accordance with section 154f of the Code of Criminal Procedure because the defendant's place of abode was unknown. In addition, the public prosecutors' offices discontinued 71 cases (previous year: 49) in accordance with section 153 of the Code of Criminal Procedure, because they considered the perpetrator's degree of fault minor and there was no public interest in criminal prosecution. Another 56 investigations (previous year: 50) were discontinued in accordance with section 153a of the Code of Criminal Procedure, after the defendants had made payments as part of out-of-court settlements.

In a further 30 proceedings (previous year: 28), the public prosecutors' offices concentrated on pursuing violations of other prohibitions under criminal law

**Table 20: Completed market manipulation proceedings**

Period	Total	Decisions by the public prosecutors' offices*					
		Investigations discontinued				Proceedings discontinued in accordance with section 153a of the Code of Criminal Procedure	Public main proceedings not commenced in accordance with section 204 of the Code of Criminal Procedure
		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		
2015	256	97	29	16	37	49	0
2016	345	166	49	28	17	50	0
2017	407	187	71	30	24	56	5
Final court judgements following criminal proceedings*						Rulings following administrative fine proceedings	
Period		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	Investigations discontinued	Final administrative fines
2015		1	10	6	1	4	6
2016		6	13	10	3	3	0
2017		5	15	4	0	3	7

\*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.

committed in parallel and discontinued the market manipulation proceedings in favour of other allegations, such as fraud or breach of fiduciary duty, in accordance with section 154 or section 154a of the Code of Criminal Procedure.

### 2.2.3 Selected cases

#### Asset manager

In January 2017, the Local Court (*Amtsgericht*) of Stuttgart handed down a sentence on the managing director of an asset management company, imposing a fine of 85 daily units, which became final in November 2017. The daily units amounted to €90, resulting in a total of €7,650. BaFin had filed a complaint with the public prosecutor's office in Stuttgart in

December 2015. The asset manager had issued offsetting block orders in an illiquid warrant on shares in Bilfinger SE on behalf of client securities accounts. By choosing the number of units, specifying order limits, and timing the orders, he coordinated the orders in such a way that they could be executed directly against each other on the Stuttgart Stock Exchange. In this way, he achieved a stock exchange price fixing that was beneficial to himself and his clients. The defendant's manipulative trades in the warrant led to a significant price increase, which was not justified by the share price performance of the underlying.

#### Xing AG

In 2017, the public prosecutor's office in Frankfurt am Main discontinued proceedings against a securities

## Definition

### Designated sponsor

Designated sponsors are banks or other financial services providers that publish binding quotes in the XETRA electronic trading system for the purchase or sale of the financial instruments they are promoting. In this process, the designated sponsors themselves undertake in principle to buy or sell financial instruments in the market at the prices they have quoted. This increases the liquidity of the promoted financial instruments. The additional liquidity provided by the designated sponsor is intended to ensure that financial instruments can be traded at any time.

trader against whom BaFin had filed a complaint with that office back in 2014. The complaint related to market manipulation by generating trading volumes in shares of Xing AG for which there was no economic justification. The proceedings were discontinued against payment of € 25,000 as part of an out-of-court settlement in accordance with section 153a of the Code of Criminal Procedure.

In March 2013, the securities trader had acted as designated sponsor (see info box "Designated sponsor") and influenced the pricing of shares in Xing AG in order to boost the volume of shares traded. Each time a trade was executed at the quote he had determined, he changed the quote in such a way that there was a fresh incentive for the market to trade at the price he was quoting. In this process, he increased his prices on the buy-side above the previously quoted sell-side prices. From the counterparty's perspective, this provided a constant incentive to close positions at a profit as soon as they had been opened, while the designated sponsor systematically accepted losses.

#### Blue Cap AG

In 2017, the Munich I public prosecutor's office concluded an investigation by handing down a sentence of 160 daily units; the case had involved trading in shares of Blue Cap AG over a three-year period. The daily units amounted to € 80, resulting in a total fine of € 12,800. The proceedings had been triggered by a criminal complaint filed by BaFin in February 2017.

During the time the crime was committed between 2014 and 2017, the defendant had comprehensive powers

of attorney for the company securities accounts of two subsidiaries. In addition, he traded through two securities accounts in his own name, although they were held at different credit institutions. He used these securities accounts over a period of several years to issue coordinated offsetting buy and sell orders on the Düsseldorf, Munich and Stuttgart stock exchanges in a total of 48 cases; these orders were executed immediately against each other. In this way, the defendant influenced the price and volume performance of the shares in Blue Cap AG.

BaFin's investigation was carried out in close cooperation with the trading surveillance units at the Düsseldorf, Munich and Stuttgart stock exchanges. The sentence handed down by the Local Court of Munich became final in November 2017.

#### Mologen AG

The fine imposed in proceedings triggered by a complaint filed by BaFin became final in April 2017. In March 2016, BaFin had filed a criminal complaint with the public prosecutor's office in Stuttgart because of market manipulation in the form of pre-arranged trades. The complaint involved five trades in shares of Mologen AG on the Stuttgart Stock Exchange. The defendant had entered into the trades by issuing offsetting securities orders for his securities account and his wife's securities account, over which he had power of attorney. The trades were executed on the last trading day of the 2013 calendar year. In his order instructions, the defendant chose to increase the buy and sell limits in stages. As a result of the manipulative trades, the price of the shares in question was pushed up gradually until the end of the year.

In June 2016, the Local Court of Stuttgart handed down a sentence, imposing a fine of € 15,000 (150 daily units at € 100). When the defendant appealed against the sentence, the Local Court of Stuttgart set a date for a full trial, for which the defendant failed to appear, however. The court ruled against the appeal. The defendant also appealed against this ruling, but the Regional Court (*Landgericht*) of Stuttgart dismissed this appeal. An appeal lodged by the defendant against the judgement of the Regional Court of Stuttgart was ultimately without success, so that the fine became final.

#### Grit International Inc.

In 2017, BaFin was informed by the public prosecutor's office in Düsseldorf that proceedings initiated by a complaint lodged by BaFin had ended with the imposition of a fine of € 70,000 in accordance with section 153a of the Code of Criminal Procedure. Back

in 2011, BaFin had filed a criminal complaint with the public prosecutor's office in Düsseldorf because of alleged market manipulation. It was alleged that a Canadian national, in cooperation with a distribution network, initially arranged for the shares of Grit International Inc. to be admitted to trading in Germany and then had them marketed.

However, the market letters he used for this purpose, which promised price increases of hundreds of percent within a matter of months, failed to point out the existing conflict of interests despite his obligation to do so. The investors therefore remained unaware that the defendant had his own financial interest in the performance of the shares. At the time of the marketing campaign, the defendant was holding several hundred thousand shares of the company in a securities account at a bank in Liechtenstein, which he was planning to sell.

Accordingly, the defendant took advantage of the demand generated by marketing the shares to sell the position he had previously acquired. In 2013, the public prosecutor's office in Düsseldorf brought charges before the Regional Court of Düsseldorf because of alleged market manipulation. The defendant was granted the right to be heard through mutual judicial assistance, and he was interviewed by police in Canada. Although the extradition of the Canadian national could not be considered, the imposition of the above-mentioned fine of € 70,000 was achieved.

### **LetsBuyIt Group AG**

In November 2017, the Local Court of Frankfurt am Main handed down a prison term of 10 months following summary proceedings initiated by a complaint filed by BaFin in December 2014. The sentence was imposed on a defendant resident in the United Arab Emirates. In addition, the court ordered the forfeiture of approximately €61,000. The sentence is final.

The public prosecutor's office in Frankfurt am Main charged the defendant with bringing about, through a large number of buy and sell orders for shares of LetsBuyIt Group AG, trades that were not intended to implement a legitimate trading strategy, but solely to generate trading volume in the stock. In more than 200 cases, the defendant sold shares in LetsBuyIt Group AG, only to repurchase them again immediately. In this process, the defendant also incurred losses, because he regularly sold the shares at a lower price than he had to pay to buy them back later.

The artificially boosted trading volume was intended to arouse interest among investors. The defendant was

acting on behalf of individuals who wanted to benefit from the increased volume of trading in LetsBuyIt Group AG shares by selling their own positions.

### **Final administrative orders imposing fines**

In 2017, BaFin imposed an administrative fine of €42,000 on the chief executive officer of a stock corporation, whose shares are admitted to trading on the regulated unofficial market (*Freiverkehr*) of the Frankfurt Stock Exchange, because he had provided incorrect price-relevant information about the company.<sup>24</sup>

At the end of 2014, the individual concerned had published information in a market letter about the expected net profit for the year, which could no longer be objectively justified at that time. The individual also repeated these comments in an interview with a local daily newspaper, which was subsequently published. Contrary to the assessment communicated by the individual concerned, according to which a profit in line with the previous year was expected, the company in fact suffered a 90 percent slump in profits compared with the previous financial year.

The claims about the expected amount of net profit for the year repeatedly made by the CEO were firstly of significant relevance to the company's valuation and secondly capable of influencing the share price of the company in question. However, as it turned out, they did not affect the share price of the company concerned. For this reason, the matter was not prosecuted as a criminal offence, but as an administrative offence.

## **2.3 Insider trading**

### **2.3.1 Investigations**

In 2017, BaFin launched 62 new investigations due to suspected insider trading (previous year: 42; see Table 21 "Insider trading investigations" on page 141). Since many of these insider trading investigations involved cross-border issues, BaFin asked foreign supervisory authorities for administrative assistance in 79 cases (previous year: 54). In turn, administrative assistance in insider trading issues was requested from BaFin in 28 cases (previous year: 35).

BaFin found evidence of insider trading in 18 cases (previous year: 21). It therefore filed complaints against 40 individuals with the competent public prosecutor's office (previous year: 49). In 11 cases,

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<sup>24</sup> See chapter II 6.

**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
2015	43	19	26	87	41
2016	42	23	21	49	39
2017	62	11	18	40	72

**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
2015	41	31	8	1	1	0	0
2016	93	75	14	3	1	0	0
2017	41	27	5	5	4	0	0

BaFin found no evidence of insider trading (previous year: 23) and therefore discontinued the investigations. 72 investigations, some of which had been initiated in prior years, had not been completed by the end of 2017 (previous year: 39).

### 2.3.2 Sanctions

In 2017, final court judgements following summary proceedings were handed down to 4 individuals (previous year: 1; see Table 22 "Completed insider trading proceedings"). The investigations resulting in these sentences were all initiated by complaints filed by BaFin. A total of 32 proceedings (previous year: 89) were discontinued by the prosecutor's office. In 27 of these cases (previous year: 75), the prosecutor's office was unable to demonstrate that a conviction was sufficiently probable to bring a charge in accordance with section 170 (2) of the German Code of Criminal Procedure (*Strafprozessordnung*). Another 5 investigations (previous year: 14) were discontinued by the prosecutor's office in accordance with section 153a of the Code of Criminal Procedure, after the defendants had made payments as part of out-of-court settlements.

### 2.3.3 Selected cases

#### VERBIO Vereinigte BioEnergie AG

Two sentences for insider trading handed down by the Local Court of Frankfurt am Main to an employee of VERBIO Vereinigte BioEnergie AG (VERBIO AG) and his mother became final in March 2017. BaFin had filed a complaint with the public prosecutor's office in Frankfurt am Main in 2016. The court imposed a fine of 90 daily units of €200 each on the employee, because he had illegally recommended the purchase of the insider securities. His mother had to pay a fine of 90 daily units of €40 each for insider trading.

On 4 November 2013, VERBIO AG published an ad hoc disclosure, in which it raised its earnings forecast for the 2013/2014 financial year (as at 30 June). Following analysis of the preliminary figures as at 30 September 2013, it was able to increase its EBITDA<sup>25</sup> to approximately €11 million (2012/2013: €1.6 million). In addition, the company was largely expecting

<sup>25</sup> Earnings before interest, taxes, depreciation and amortisation.

EBIT<sup>26</sup> to break even in the 2013/2014 financial year (previously: –€5.0 million). After the publication of the disclosure, the VERBIO share price rose by 30 percent.

A few days before the disclosure, the VERBIO employee's mother began to buy shares of the company, in an amount eventually totalling approximately €51,824. She sold them at a profit between March and May 2014.

### Alphaform AG

In another insider trading case, which was initiated by a complaint filed by BaFin in 2015, the Local Court of Munich handed down a sentence to a department head of Alphaform AG in November 2017, imposing a fine of 90 daily units of €90 each. In addition, the court ordered an amount of €10,000 forfeited.

Although the proceedings against another employee of the company, who had passed inside information to the department head without authorisation, were discontinued, this individual had to pay a fine of €4,000.

Alphaform AG announced on 28 July 2015 that it had lodged an application for insolvency with the Local Court of Munich because of imminent insolvency. On the next day, the price of Alphaform shares on Xetra opened at €0.64, almost 70 percent down on the previous day's closing. In the course of that day, the shares traded more than 80 percent lower at times.

BaFin's investigations found that the employee had passed inside information to the department head without authorisation. On the basis of this information, the individual sold 10,000 Alphaform shares only about an hour before the insolvency disclosure was published, thus avoiding the fall in the share price.

### Hugo Boss AG

On 3 February 2017, the prosecutor's office in Frankfurt am Main discontinued insider trading proceedings against payment of €1,000. The proceedings had been initiated by a complaint filed by BaFin in 2016. The defendant, a senior executive at Permira, a major shareholder of Hugo Boss AG, admitted the charges and had previously made a voluntary donation of €3,500.

At 8.29 p.m. on 2 May 2013, the Bloomberg news service reported that Permira was planning to place seven million Hugo Boss shares (9.9 percent of the subscribed capital) in an accelerated book-building process. This report was confirmed in an ad hoc disclosure published

by Hugo Boss AG at 8.01 a.m. on 3 May 2013 and further details were provided. According to this disclosure, Red & Black Holding GmbH, a subsidiary of Permira, was planning to reduce its interest to 56 percent. Following the publication of the Bloomberg report, the opening price of the stock on Xetra on the morning of 3 May 2013 was €88.95, down four percent on the previous day's closing price. The share price continued to decline in the course of the day, closing at €87.08, around six percent lower than the previous day's close.

In the course of 2 May 2013, the above-mentioned senior executive at Permira bought a total of 21,100 put warrants on Hugo Boss, splitting his buy orders among three different issuers of warrants. He sold the warrants after the news was published and thus made a total profit of €3,003.

## 2.4 Ad hoc disclosures and managers' transactions

### 2.4.1 Ad hoc disclosures

In the year under review, issuers published a total of 2,197 ad hoc disclosures (previous year: 1,755; see Figure 11 "Ad hoc disclosures and exemptions" on page 143), thus continuing the significant rising trend that was beginning to emerge in the second half of 2016 – brought about by the entry into force of the Market Abuse Regulation (MAR). Approximately 1,350 issuers, including 530 issuers of securities, were required to make ad hoc disclosures in 2017. However, issuers listed on the regulated unofficial market (*Freiverkehr*) or on a multilateral trading facility (MTF) are only subject to the publication requirement if they have consented to or authorised the listing. As from 3 January 2018, this also applies to issuers whose securities are listed with consent or approval on an organised trading facility (OTF). In line with the rise in the number of ad hoc disclosures, the number of notifications of a delay in publishing the disclosure also continued to increase (484; previous year: 403). In accordance with Article 17(4) of the Market Abuse Regulation, an issuer can temporarily delay the disclosure of inside information on the basis of a delay decision.

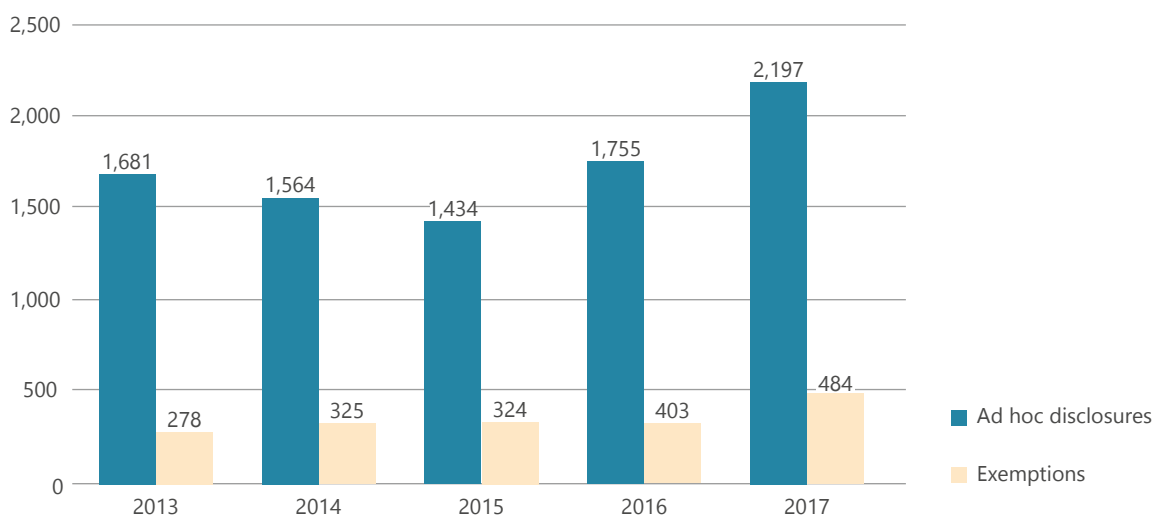
### Areas in BaFin's focus

In 2017, BaFin again focused on the implementation of the Market Abuse Regulation and the accompanying legal provisions. There were queries, for example, about the language in which MTF issuers may publish documents, and also about which authority had a duty of supervision in particular cases. Another important issue was the assessment of intermediate steps in an

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<sup>26</sup> Earnings before interest and taxes.

**Figure 11: Ad hoc disclosures and exemptions**



extended process, for example in relation to mergers and acquisitions. These intermediate steps, too, and not just the end result, may constitute inside information and therefore require disclosure to the public.

At two workshops, BaFin provided information on the publication of inside information and how to handle it. In preparation for extending the ad hoc disclosure requirement for participants in the market for emission allowances as from 3 January 2018 – entry into force of these provisions of the Market Abuse Regulation had been postponed by one year – it published a number of questions and answers (FAQs) on its website, [www.bafin.de](http://www.bafin.de). Article 17(2) of the Market Abuse Regulation requires every emission allowance market participant to disclose inside information concerning emission allowances which it holds in respect of its business. This includes the planned or unplanned unavailability of an installation. However, this obligation only applies if its installations or aviation activities have emissions that exceed specific minimum thresholds.

In its FAQs, BaFin explains, among other things, how this minimum threshold are to be calculated and what inside information may be subject to the disclosure requirement. Another important issue is the disclosure privilege: emission allowance market participants that are already required under Article 4 of Regulation (EU) 1212/2011 (REMIT) to disclose inside information – this refers to wholesale energy companies – do not have to make any additional disclosures of inside information in accordance with Article 17(2) of the Market Abuse Regulation, providing this is essentially the same information and there is a

guarantee that the inside information is disclosed to the relevant media.

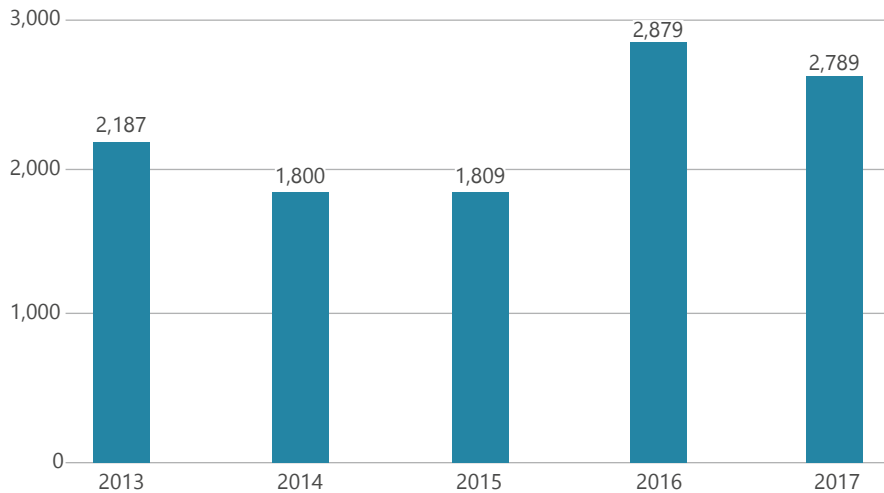
## 2.4.2 Managers' transactions

Executives (e.g. 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 2,789 securities transactions in 2017 (previous year: 2,879; see Figure 12 "Reports of managers' transactions" on page 144). Following a sharp increase in the number of reports in 2016, the 2017 figure was on a level with the previous year.

BaFin examined the reports to verify whether the three-day period within which managers' own-account transactions have to be notified had been complied with (145 cases), whether the 30-day prohibition on trading prior to the publication of financial figures had been observed (7 cases), and whether the managers had been informed of their reporting obligations by the issuer (2 cases). As a result of the Market Abuse Regulation's entry into force on 3 July 2016, the time period allowed for meeting the reporting obligation has been cut from five to three business days, and issuers are now required to inform their managers about the legal reporting obligations. BaFin pursued 3 cases further in administrative fine proceedings and discontinued 28 cases.

There continues to be a very large number of sometimes complex interpretive questions, which – if they are of general relevance – BaFin collates in a continually

**Figure 12: Reports of managers' transactions**



updated catalogue of FAQs; the FAQs are available on the BaFin website, [www.bafin.de](http://www.bafin.de). BaFin does so to ensure that the legal standards are applied consistently. In addition, it wants to give market participants guidance for action by providing practical examples.

## 2.5 Monitoring of short selling

### 2.5.1 Prohibitions

The EU Short Selling Regulation prohibits uncovered short selling of shares and certain sovereign debt instruments. This also applies to the creation of, or entry into, sovereign credit default swaps (CDSs) other than for hedging purposes. In 2017, BaFin followed up on suspicious transaction reports and its own evidence in 100 cases (previous year: 97). The suspicious transaction reports related to sales by companies and private individuals. BaFin also received 72 voluntary self-reports.

It discontinued 79 investigations (previous year: 78), 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 31 December 2017, the investigation of 19 cases had not yet been completed (previous year: 8); of this total, 1 dates from 2016 and 18 from 2017. BaFin referred another 6 cases to other EU authorities for reasons of competence (previous year: 11). 13 cases were pursued further in administrative fine proceedings (previous year: 11).

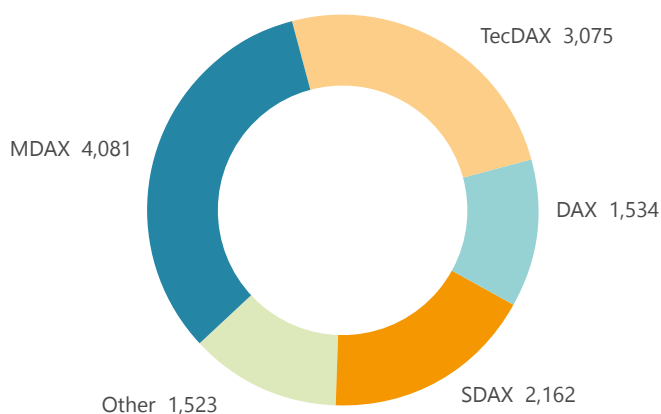
### 2.5.2 Transparency requirements

BaFin investigated 38 violations of the transparency requirements for net short positions in (previous year: 61). It discontinued a total of 26 investigations (previous year: 25). As at 31 December 2017, the investigation of 12 cases had not yet been completed (previous year: 18).

Net short positions are reported using BaFin's reporting and publishing platform. By the end of 2017, 1,190 companies and 23 private individuals had used the facility to submit a total of 2,431 applications for approval to use the system. As in previous years, most of the parties subject to the notification requirement came from the United States and the United Kingdom. In 2017, 285 parties subject to the notification requirement (previous year: 331) notified BaFin of a total of 12,861 net short positions (previous year: 14,492) in 281 different shares (previous year: 249) admitted to trading on a regulated market or multilateral trading facility. This corresponds to an average of 51 notifications per trading day. A total of 4,001 notifications (previous year: 4,151) had to be published in the Federal Gazette (*Bundesanzeiger*) in 2017, because the threshold of 0.5 percent of the share capital in issue had been crossed or reached. In addition, BaFin received 135 notifications for federal government debt securities (initial threshold: 0.5 percent), significantly more than in the previous year (94 notifications). By contrast, as in the previous year, there were no notifications for debt securities of the federal states (initial threshold: 0.1 percent). Most of the net short positions were built in shares by issuers on the regulated market (see Figure 13 "Notifications broken down by index" on page 145).



**Figure 13: Notifications broken down by index**



### 2.5.3 Notifications by market makers

In 2017, 44 market makers (previous year: 48) and 30 primary dealers (previous year: 32) notified BaFin of their activities and made use of the exemptions from the prohibitions on short selling and transparency requirements laid down in Article 17 of the EU Short Selling Regulation (see Table 23 “Notifications by market makers and primary dealers in 2017”). A total of 33 of the 44 market makers submitted notifications of intent, which are required when market makers expand their activities by adding a new instrument or when primary dealers extend their operations to include government debt securities of another issuer. In 2017, BaFin received a total of 1,570 notifications of intent (previous year: 1,207) from market makers and no notifications of intent from primary dealers (previous year: 1).

**Table 23: Notifications by market makers and primary dealers in 2017**

	Market makers	Primary dealers
Total number of companies	44	30
of which based in Germany	40	9
of which based abroad	4*	21**
Total number of notifications in 2017	1,570	0
Total number of notifications since September 2012	6,442	38

\* Non-EU third country.

\*\* Domiciled outside Germany.

### 2.6 Supervision of financial market infrastructures

#### Central counterparties

In January 2017, Eurex Clearing AG (ECAG) applied to BaFin to have its original authorisation under the European Market Infrastructure Regulation (EMIR)<sup>27</sup> extended to include the clearing of over-the-counter foreign exchange (OTC FX) products. Since this is a new product category, ECAG had to adapt and expand the risk management for the products to be cleared. BaFin reviewed the application together with the Deutsche Bundesbank, held consultations in the ECAG-EMIR supervisory college and authorised the extension in November 2017.

#### ESMA stress test for CCPs

CCPs in Europe are well positioned to withstand market turbulence. That was the result of ESMA's second EU-wide stress test published on 2 February 2018. The aim was to verify whether the European CCPs hold adequate prefunded collateral and liquidity to be resilient to the default of the two most important clearing members throughout the EU, even during periods of extreme market movements and with simultaneous price shocks. ESMA concluded that the CCPs would be capable of dealing with such a scenario. It was unable to detect any contagion effects on non-defaulted clearing members that had a share in the losses through default funds or because of obligations to make additional payments. The test also revealed that the European CCPs had adequate resources to cover the liquidity requirement if the two most important clearing members or liquidity providers defaulted.

<sup>27</sup> For details on EMIR, see chapter II 1.

The stress test was triggered by EMIR, under which ESMA has to perform such a stress test once a year. A total of 16 European CCPs, including two in Germany, were assessed.

### EU authorisation procedure for CSDs

The authorisation of European central securities depositories (CSDs) will be delayed to the second half of 2018 or even into 2019. This is because almost all the applications for authorisation were incomplete. The European CSDs had to submit to the competent supervisory authorities their application documents for new registration of their CSD core services and banking-type ancillary services – required in accordance with the Central Securities Depositories Regulation (CSDR)<sup>28</sup> – by the end of September 2017. The competent authorities (including BaFin), in consultation with the central banks and other supervisory authorities whose involvement may be required, have to make a decision on the applications within six months of receipt of the complete set of documents.

## 2.7 Supervision of OTC derivative transactions and compliance with position limits

Pursuant to EMIR, financial and certain non-financial counterparties have to clear standardised OTC derivatives through a CCP.<sup>29</sup> Alternative methods of risk mitigation, such as collateralisation, must be applied to OTC derivative transactions that do not have to be cleared through a CCP. In addition to the clearing obligation, which has been in force since 2016, 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 that are not cleared through a CCP.<sup>30</sup> Under these provisions, financial counterparties have to provide collateral for OTC derivative contracts that are not cleared centrally. Non-financial counterparties are only subject to this requirement if their volume of derivatives exceeds a threshold. In the period under review, BaFin accompanied the market participants as they implemented the provisions and discussed relevant interpretive issues with the companies and at the European level. Doubt about the specific interpretation of the provisions associated with this was raised in particular by the option to obtain exemption from the collateralisation obligation for transactions

conducted within a consolidated or supervisory group. For example, the concept of group company required clarification in this context. Discussion was also required of the specific way the business volume exempted from collateralisation is calculated. Another relevant question was how market participants can identify non-netting jurisdictions.

However, the option for companies to have their transactions within the consolidated or supervisory group exempted from collateralisation is subject to BaFin's approval, unless both counterparties belonging to the group are domiciled in Germany. BaFin received a total of 172 requests to this effect in 2017 (see Table 24 "Notifications and requests").

**Table 24: Notifications and requests**

	<b>Notifications/ requests</b>
Total number of notifications/requests	<b>172</b>
One counterparty domiciled in other EU member state	102
One counterparty domiciled in third country	70

In parallel, companies that have been subject to the clearing obligation for OTC derivatives since 2016 can request an exemption for intragroup transactions. BaFin received a total of 20 requests to this effect in 2017, compared with as many as 140 in 2016.

The requirements for position limits and position reporting for commodity derivatives laid down in MiFID II have been in force since the beginning of 2018. The provisions of MiFID in this area were introduced to improve the functioning and transparency of the financial and commodity markets and prevent excessive fluctuations in commodity prices. In order to achieve this, now that MiFID II has entered into force, position limits have to be specified on the basis of a methodology determined by ESMA, which a company can hold at an aggregate group level in order to prevent both market abuse and the build-up of market-distorting positions. In preparation, BaFin set indicative limits to this effect and prepared and held hearings on eight general administrative acts in 2017. In parallel, BaFin developed the technical infrastructure for the position reports, because MiFID's entry into force means that the trading venues have to submit daily reports on the positions in commodity derivatives of their trading participants and their clients.

<sup>28</sup> OJ L 257 dated 28 August 2014, p. 1 ff.

<sup>29</sup> See 1.2.

<sup>30</sup> OJ L 340/9.

## 2.8 Voting rights and duties to provide information to securities holders

### Voting rights

3,476 changes in voting interests were reported in 2017 (see Figure 14 "Voting rights notifications"; previous year: 3,327<sup>31</sup>). Of this total, 2,214 submissions were attributable to group notifications, in which the ultimate parent undertaking reports changes in or levels of equity interests. 455 group notifications were provided voluntarily, i.e. they related to matters for which only subsidiaries had a reporting obligation, but the ultimate parent (voluntarily) submits a group notification that exempts the subsidiaries from this obligation. The majority of notifications (2,674) related to changes in voting rights triggered by the number of voting rights reaching or crossing certain thresholds (sections 33 and 34 of the German Securities Trading Act (*Wertpapierhandelsgesetz*)). 204 notifications (also) included changes resulting from holdings of financial instruments reaching or crossing thresholds (section 38 of the Securities Trading Act) and 219 notifications were (also) due to the aggregated voting rights and holdings of financial instruments reaching or crossing thresholds (section 39 of the Securities Trading Act). 436 notifications concerned changes that were not related to thresholds.

In 2017, 602 companies were admitted to trading on the regulated market. This means that the figure was again slightly down on the previous year (614). By contrast, the

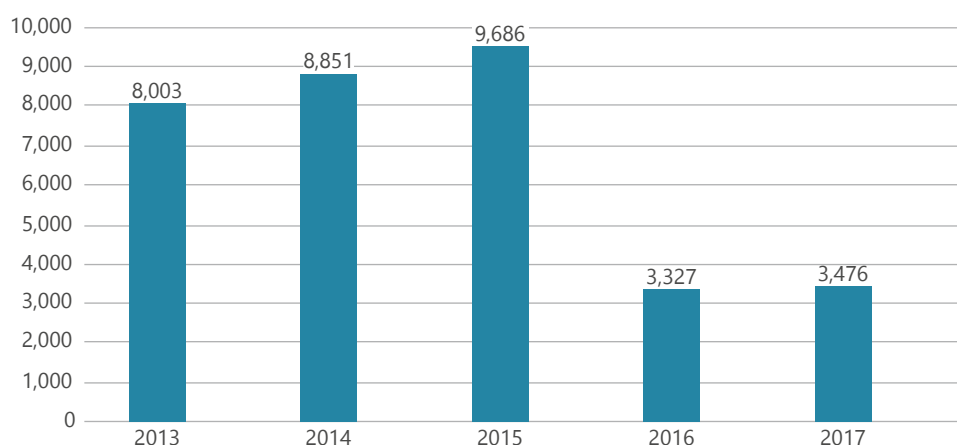
number of notifications these companies published on changes in their voting share capital increased slightly to 313 (previous year: 265). 4 real estate investment trusts (REITs) were subject to the reporting requirement at the end of 2017.

### Two years since the Transparency Directive was amended

In 2017, the number of voting rights notifications was similar to the previous year, at 3,476. Around 2,214, and therefore more than half of all notifications, were group notifications. Changes to the reporting system had already caused a considerable decline in the number of voting rights notifications in 2016, their number declining by around two thirds, from 9,686 in 2015 to 3,327 in 2016.<sup>32</sup> This meant that a key objective of the above-mentioned amendments – the sustained simplification of the reporting system by combining report data into a single notification – was achieved.

As a result of the German Act Implementing the Transparency Directive Amending Directive (*Umsetzungsgesetz zur europäischen Transparenzrichtlinie-Änderungsrichtlinie*), comprehensive changes to the voting rights reporting system entered into force at the end of 2015. In addition to implementing the mandatory requirements of the revised Transparency Directive, additional amendments introduced by German legislators were aimed at simplifying the reporting system and bringing it closer in line with European standards. This is intended to benefit

Figure 14: Voting rights notifications



31 Figure adjusted. 2,378 notifications were reported in the 2016 Annual Report.

32 Figure adjusted. 2,999 notifications were reported in the 2016 Annual Report.

the transparency of voting rights notifications. For example, a mandatory report form has been introduced, which covers all three notification criteria the issuer has to disclose. In addition, the point at which a threshold is reached or crossed has been brought forward from the time of actual transfer to the time the contractual obligation arises, if the transaction concerned is unconditional and has to be settled without delay. In addition, since the end of 2015, group notifications have been sufficient, i.e. only the ultimate parent undertaking submits a voting rights notification in the case of parent-subsidary relationships.

#### Earlier crossing point

The fact that the threshold crossing point has been moved forward has also simplified the process in practice, especially in cases where both the buyer and the seller have to submit a notification. Previously, it was common for both parties to provide different information about the time the threshold was reached or crossed, and this normally entailed subsequent corrections.

The concerns voiced during the legislative process about plans to move this point forward have not materialised. For example, there has only been a negligible number of cases where there have been delays in the completion of the contractual transaction, thus necessitating a correction to the original notification.

Notifications of corporate actions have also become more transparent: they are now generally only submitted by new and existing shareholders if these actions reach or cross a threshold. Notifications by consortium banks are a special case: since BaFin revised its administrative practice at the end of 2015, they can apply the exemption for clearing settlement transactions (section 23 of the Securities Trading Act, old version, section 36 of the Securities Trading Act, new version).

#### Electronic reporting system planned for 2018

The introduction of another expedient for voting rights notifications, an electronic reporting system, is planned for 2018.

## 3 Prospectuses

### 3.1 Securities prospectuses

BaFin approved a total of 1,405 securities prospectuses, registration documents and supplements in 2017. This was an approximately 15 percent decline in the number

of approvals compared with the previous year (1,652; see Table 25 "Number of approvals in 2017 and 2016").

254 of the 301 prospectuses approved in 2017 were prospectuses for the issuance programmes of large issuers (banks, savings banks). The total number of base prospectuses decreased and, in line with it, the number of supplements also declined. 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.

Despite the fall in the number of prospectuses approved in 2017, the total number of final terms filed indicates that the banks engaged in lively issuance activity. The number of final terms increased from 3,260,884 in 2016 to 3,491,583.

**Table 25: Number of approvals in 2017 and 2016**

Product	2017	2016
Prospectuses	301	348
Registration documents	38	33
Supplements	1,066	1,271
<b>Total</b>	<b>1,405</b>	<b>1,652</b>

The number of notifications BaFin transmitted to other national supervisory authorities, e.g. in Austria and Luxembourg, under the European Passport declined for the first time since 2014 (3,143; previous year: 3,935). The number of notifications received also decreased to 692 (previous year: 849). Over 60 percent of the notifications came from Luxembourg.

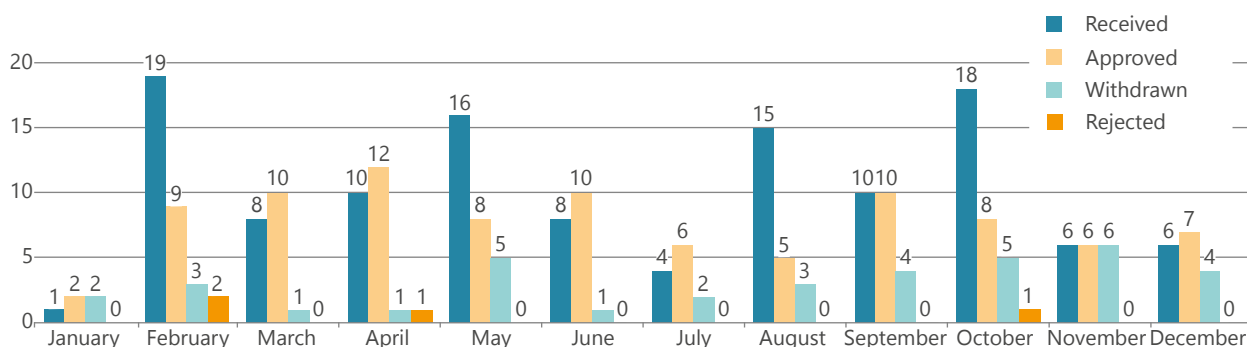
Due to the rise in the number of final terms filed, the total issue volume of 3,491,656 was higher than in the previous year (3,260,986).

### 3.2 Non-securities investment prospectuses

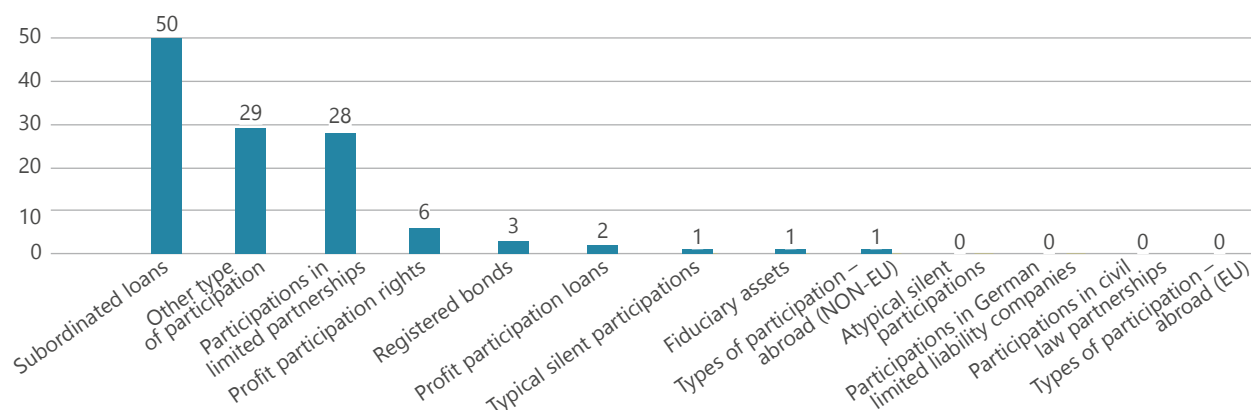
In 2017, BaFin received a total of 121 non-securities investment prospectuses for checking. The decline from the 179 documents received in the previous year was due to market-related factors (see Figure 15 "Prospectuses received, approved, withdrawn and rejected" on page 149). BaFin approved 93 prospectuses (previous year: 77). The remaining processes had not been finalised by the end of the year.

50 prospectuses – almost half of the total – related to subordinated loans (approximately 41 percent,

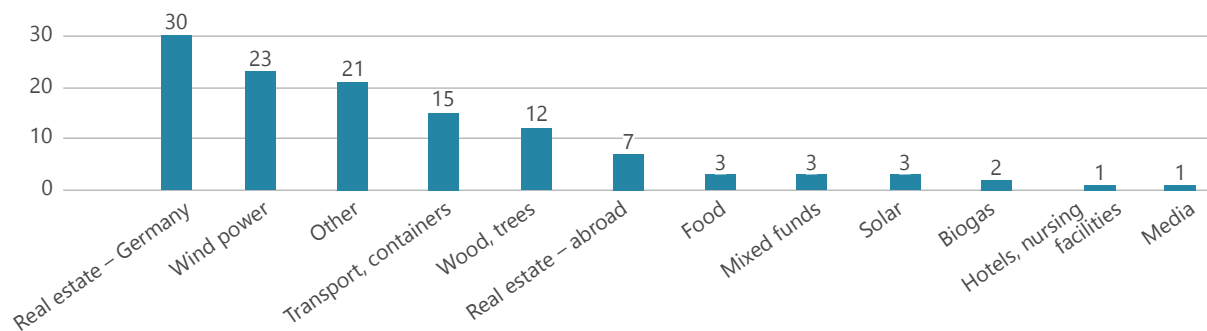
**Figure 15: Prospectuses received, approved, withdrawn and rejected**



**Figure 16: Prospectuses by type of participation**



**Figure 17: Prospectuses by target investment**



previous year: approximately 39 percent), thus continuing the trend in this type of participation (see Figure 16 “Prospectuses by type of participation”). They were followed by other investments (for example, direct investments in containers or tree plantations), which accounted for 29 prospectuses (approximately 24 percent; previous year: approximately 17 percent). Participations in limited partnerships were in third place in 2017, with 28 prospectuses received (approximately 23 percent; previous year: approximately 22 percent).

In terms of target investments (see Figure 17 “Prospectuses by target investment”), real estate (in Germany and abroad) is now in the lead, with a total of 37 prospectuses received (approximately 31 percent; previous year: approximately 20 percent). They beat renewable energies (wind power, solar, biogas) into second place, with 28 prospectuses received (approximately 23 percent; previous year: approximately 25 percent). 21 of the prospectuses received related to other target investments such as blind pool structures

(approximately 17 percent; previous year: 28 percent), which therefore continue to represent a significant share alongside the traditional variants.

In 2017, a total of 41 applications for the approval of supplements under the German Capital Investment Act (*Vermögensanlagengesetz*) were received, an increase compared with 24 applications received in the previous year. BaFin approved 36 supplements in the year under review (previous year: 13).

### **Amendments affecting capital investments information sheets**

In the year under review, BaFin received a total of 452 capital investments information sheets for crowdfunding projects (previous year: 263): 251 for filing up to and including 20 August 2017 and 201 for approval from 21 August 2017 (see info box "Approval process for capital investments information sheets").

### **3.3 Prospectus requirement**

In 2017, approximately 150 market surveillance proceedings were conducted for possible violations of the Capital Investment Act and the German Securities Prospectus Act (*Wertpapierprospektgesetz*) (previous year: 119). As part of this process, BaFin firstly investigated tips it had received, and secondly it conducted its own checks of offers and the way they were marketed. In over 80 percent of these approximately 150 cases, it investigated whether capital investments or securities were offered to the public without publishing a prospectus in violation of the obligation to do so. BaFin completed 92 investigations in 2017. Where violations were identified while the offer was still ongoing, the offer was either prohibited, or the irregularity was made public. 23 of the investigations completed related to a suspected public offer of shares, in 17 cases it involved a public offer of bonds, and

15 investigations dealt with direct investments, i.e. other types of investment.

BaFin found 17 violations of the prospectus requirement by providers of subordinated loans, significantly fewer than the 49 identified in the previous year. The decline is attributable to the fact that BaFin regularly informs the providers concerned of violations and prosecutes such violations.

There was also a slight reduction in the number of investigations due to suspected public offers of shares within the meaning of section 1 (2) no. 1 of the Capital Investment Act, such as shares in partnerships (in particular OHG and KG) or shares in German limited liability companies (GmbH).

Marketing violations represented 20 percent of market surveillance proceedings in the year under review. All investigations into marketing violations were completed. Most cases, 17 in total, related to violations of the notification requirements laid down in section 12 (2) of the Capital Investment Act. The main concern was not that there was no warning. Rather, BaFin mostly found fault with the fact that it was not clearly highlighted. In 8 cases, it criticised that there was no warning relating to the promised return in the marketing material for investments offered to the public (section 12 (3) of the Capital Investment Act). In 7 cases, the reference to the prospectus and its publication, which section 12 (1) of the Capital Investment Act requires to be included in the marketing material for investments offered to the public, was only added after the Market Surveillance unit had taken action. In a total of 3 cases, an objection was raised to a reference to BaFin in the marketing material for investments offered to the public, which is unlawful pursuant to section 12 (4) of the Capital Investment Act. Only 1 case related to a marketing violation under the Securities Prospectus Act.

#### **Legal background**

### **Approval process for capital investments information sheets**

As of 21 August 2017, a formal approval procedure for capital investments information sheets was introduced into legislation. As a result of this procedure, more detailed minimum information has to be included and the information has to be presented in a specific order. This makes it easier for consumers to compare the information. The new provisions apply to capital investments information sheets submitted together with a prospectus.

In addition, they apply to capital investments information sheets where the public offer can be made without a prospectus because it meets the exemption criteria of sections 2a and 2b of the Capital Investment Act, especially in connection with crowdfunding. Before these provisions entered into force, the capital investments information sheets only had to be submitted to BaFin for filing.

# 4 Company takeovers

## Offer procedures

BaFin checked a total of 23 offer documents (previous year: 22) in 2017 and approved their publication in 22 cases, as in the previous year (see Figure 18 “Offer procedures 2013 to 2017”). It prohibited the publication in 1 case.

## Takeover bids for STADA Arzneimittel AG

STADA Arzneimittel AG was the subject of two takeover bids in 2017. On 26 June 2017, Nidda Healthcare Holding AG disclosed the failure of its takeover attempt to the public. The offer document published on 27 April 2017 stipulated a minimum acceptance threshold. The bid failed because an insufficient number of shareholders accepted the offer. Already on 19 July 2017, Nidda Healthcare Holding AG submitted a second takeover bid to the shareholders of STADA Arzneimittel AG. It was able to do so, because BaFin had exempted Nidda Healthcare Holding AG from the exclusion period in accordance with section 26 (1) sentence 2 of the German Securities Acquisition and Takeover Act (*Wertpapiererwerbs- und Übernahmegesetz*) (see info box “Exclusion period”).

What swayed BaFin’s decision in the STADA case was that Nidda Healthcare Holding AG indicated that it wanted to make a second offer quickly, thus proving that it had a serious interest in the decision it was seeking. The target company’s consent had also been given. Moreover, an assessment of the interests of the two parties did not provide any arguments against an exemption. In particular, there were no indications that the target company’s consent had been influenced

## Legal background

### Exclusion period

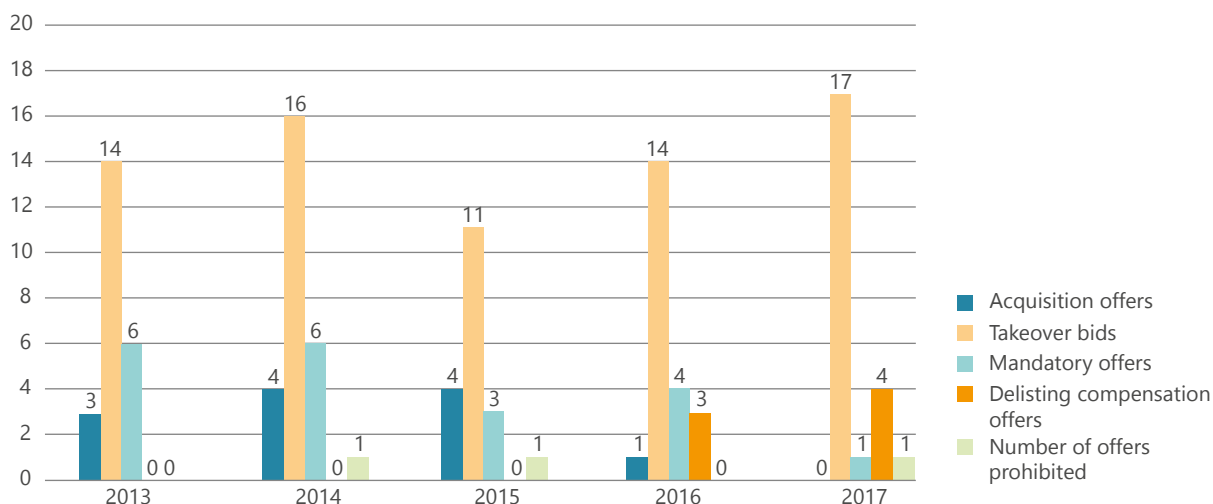
If BaFin prohibits an offer in accordance with section 15 (1) or (2) of the Securities Acquisition and Takeover Act or the offeror fails to reach the chosen minimum acceptance level, section 26 (1) sentences 1 and 2 of the Securities Acquisition and Takeover Act specifies a one-year exclusion period before a new offer can be made. BaFin can exempt the offeror from this requirement in accordance with section 26 (2) of the Securities Acquisition and Takeover Act, if the target company consents to the exemption.

by extraneous considerations, such as the prospect of lucrative positions for its board members following a successful takeover. For this reason, BaFin was able to approve the application of Nidda Healthcare Holding AG. The renewed offer was successful, with an acceptance ratio of approximately 65.28 percent.

## Takeover bids for Pfeiffer Vacuum Technology AG

There were also two takeover bids for Pfeiffer Vacuum Technology AG in 2017. Pangea GmbH published its first takeover bid on 13 February 2017, subject to a number of conditions. For example, the target company was not allowed to call a general shareholders’ meeting in connection with the offer. However, the Management Board of Pfeiffer Vacuum Technology AG called such a meeting on 7 March 2017 – for the purpose of discussing the takeover bid. This caused the bid to fail. Although the offeror is generally free to waive conditions up to one working day before the end of the acceptance period,

Figure 18: Offer procedures 2013 to 2017



this can only be done in advance. It is not possible to subsequently waive a failed condition. Pangea GmbH was therefore unable to pursue its takeover bid.

On 12 April 2017, Pangea GmbH published a new takeover bid, which specified consideration above the level of the first bid. The exclusion period did not apply to this second bid, because the first bid had neither been prohibited nor had it failed because of not reaching a minimum acceptance threshold. On 27 June 2017, Pangea GmbH announced that the takeover bid for a total of 22,828 shares of Pfeiffer Vacuum Technology AG (corresponding to 0.23 percent of the share capital and voting rights) had been accepted.

#### **Delisting compensation offer of the target company**

According to BaFin's settled administrative practice, a public offer by a target company to repurchase its own shares does not constitute a takeover bid within the meaning of the Securities Acquisition and Takeover Act. However, this administrative practice does not apply in cases where a target company wishes to make an offer within the meaning of section 39 (2) of the German Stock Exchange Act (*Börsengesetz*) (delisting compensation offer).

The first time a target company made a delisting compensation offer to its own shareholders occurred on 12 September 2017. Rheintex Verwaltungs AG (formerly Rheinische Textilfabriken AG) was both offeror and target company in this process.

The offeror's obligation to make a delisting compensation offer to all shareholders of the target company was in conflict with the restrictions of stock corporation law, which apply if the offeror and the target company are identical. In addition to the provisions of section 71 (1) of the German Stock Corporation Act (*Aktiengesetz*), the offeror absolutely had to comply with the maximum limit of 10 percent of the share capital specified in section 71 (2) sentence 1 of the Stock Corporation Act. To this end, the offeror entered into non-acceptance agreements with five shareholders, which accounted for a share of 90.051 percent of the voting rights. In addition, these shareholders undertook to enter into agreements with their banks to block their securities accounts. To enable BaFin to accept these types of arrangements as a financing measure, they have to specify an indisputable claim to compensation in favour of the offeror for the case that the offer is accepted for the shares in question – even though arrangements to the contrary have been agreed.

The acceptance ratio in the first delisting compensation offer by a target company to its own shareholders was 1.05 percent of the share capital and voting rights of the target company.

#### **Exemption procedures**

BaFin received 45 applications for exemption or non-consideration (previous year: 44). In 29 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: 21), while the other 16 applications for exemption were applications for exemption in accordance with section 37 of the Securities Acquisition and Takeover Act (previous year: 21). BaFin approved 35 applications. 3 applications were withdrawn and 19 were still being processed at the end of 2017.

#### **No third-party protection in the Securities Acquisition and Takeover Act**

In its decision of 8 January 2018<sup>33</sup>, the Higher Regional Court (*Oberlandesgericht*) of Frankfurt/Main confirmed its previous ruling that the Securities Acquisitions and Takeover Act does not grant third-party protection. The court's decision took into account, among other factors, recent civil law rulings on claims under takeover law by a civil division of the Higher Regional Court of Frankfurt/Main<sup>34</sup> and by the Federal Court of Justice (*Bundesgerichtshof*)<sup>35</sup> as well as the history of and the following amendments to the Securities Acquisition and Takeover Act.

According to the decision of the Higher Regional Court of Frankfurt/Main, no subsequent administrative third-party protection had to be given to shareholders. This applied, even if shareholders had not accepted a takeover bid and could not assert any claims under civil law because the consideration in the takeover bid had been too low. The Higher Regional Court of Frankfurt/Main thus made it clear that the preceding civil law decisions had no bearing on BaFin's administrative proceedings.

Moreover, the court rejected the complainant's argument that third-party protection in favour of the shareholders who reject the takeover bid could be derived from the original reasons for section 50 of the Securities Acquisition and Takeover Act or subsequent amendments to the Securities Acquisition and Takeover Act.

33 Case ref. WpÜG 1/17.

34 See judgement of 19 January 2016, case ref. 5 U 2/15.

35 See judgement of 7 November 2017, case ref. II ZR 37/16.



# 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) declined again in 2017 (see info box “ESMA peer review”).<sup>36</sup> As at 1 July 2017, 561 companies (previous year: 615) from 8 countries (previous year: 9) were affected.

The FREP completed a total of 99 examinations in 2017 (previous year: 96), of which 91 were sampling examinations. BaFin itself performed financial reporting enforcement procedures at 18 companies (previous year: 16) and ordered the publication of errors in 15 cases. The FREP had previously identified errors in agreement with the relevant companies in 13 of the 18 cases (see Table 26 “Enforcement procedures completed” on page 154). The remaining 5 cases were based on error identification procedures performed by BaFin. In 2 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 2 of the 5 cases ended in error findings. For these 2 procedures, BaFin ordered the publication of the findings. The procedures related to various accounting issues, such as earnings per share, reported equity or deferred taxes. 8 cases were still pending at BaFin at the end of 2017.

## Publication of financial reports

In 2017, BaFin examined in approximately 930 cases whether the issuers had published their online annual and half-yearly financial reports on time (previous year: 940). In 16 cases – significantly fewer than in the previous year (27) – it found indications of violations, which it pursued further in administrative fine proceedings.<sup>38</sup> The decline is mainly attributable to two factors: some of the issuers that had not met their obligations in 2016 did so in 2017, while others ceased to admit securities on the organised market.

As in the previous year, BaFin continued to focus on the publication of notifications, which are intended to provide information on when and where financial reports are published on the internet. In 31 cases, issuers whose registered office is in Germany failed to publish these notifications; BaFin pursued these cases in administrative offence proceedings.<sup>39</sup> In 29 cases, this related to the publication of notifications on annual financial reports (previous year: 34); half-yearly reports were involved in 2 cases. In all 29 cases, the issuers had not only neglected to publish the notifications, but also failed to publish the financial reports themselves. The publication of annual reports by issuers whose registered office is in Germany is monitored by the Federal Office of Justice (*Bundesamt für Justiz*).

BaFin’s examination again included verifying whether the published half-yearly financial reports contained the minimum components required by law. In 13 cases it found, for example, that there was no responsibility statement. In another case, the notes to the interim

### Legal background

## ESMA peer review

In 2017, the two-tier German financial reporting enforcement procedure was assessed as part of a peer review by ESMA, which did not find any violations of the “ESMA Guidelines on Enforcement of Financial Information”.<sup>37</sup> ESMA published the guidelines in 2014 to ensure the quality of the national enforcement systems. During the peer review, ESMA gained an overview of the resources available to the national competent authorities (Guideline 2). In addition, it assessed the methods applied in the selection of the

issuers to be reviewed (Guideline 5). Finally, it also verified how effective the respective enforcement systems actually are (Guideline 6). All ESMA members were included in the peer review through a questionnaire. The peer review also involved a number of on-site visits in certain countries, including Germany. The European supervisory authority identified areas where the contents of the guidelines themselves could be improved. A new temporary working group has been set up to deal with this issue.

<sup>36</sup> See 2016 Annual Report, pages 191 ff.

<sup>37</sup> ESMA press release of 18 July 2017.

<sup>38</sup> See 7.1.

<sup>39</sup> See chapter II 6.

**Table 26: Enforcement procedures**

	<b>Error finding: yes</b>	<b>Error finding: no</b>	<b>Error publication: yes</b>	<b>Error publication: no</b>
Companies accept FREP's findings	13	n/a	13	0
Companies do not accept FREP's findings	2	0	2	0
Companies refuse to cooperate with FREP	0	3	0	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
<b>Total</b>	<b>15</b>	<b>3</b>	<b>15</b>	<b>0</b>

financial statements had not been included. BaFin pursued these 14 cases further in administrative fine proceedings.

BaFin launched 8 administrative procedures to enforce the financial reporting requirements (previous year: 13). A total of 14 proceedings were still pending from previous years, and 5 proceedings were concluded by BaFin in 2017. Most of the pending proceedings are at the enforcement stage. BaFin threatened coercive fines in 8 cases; it imposed coercive fines of up to €402,500 and initiated enforcement measures in 9 cases.

The German Act Implementing the Transparency Directive Amending Directive (*Umsetzungsgesetz zur europäischen Transparenzrichtlinie-Änderungsrichtlinie*) also resulted in changes to the way the publication of financial reports in accordance with section 37v *et seq.* of the German Securities Trading Act (*Wertpapierhandelsgesetz*), old version (sections 114 *et seq.* of the Securities Trading Act, new version) is monitored.

BaFin received a new supervisory tool in accordance with section 40c of the Securities Trading Act, old version (section 124 of the Securities Trading Act, new version): it now has to disclose, immediately on its website, the decisions on measures and sanctions it has taken in response to violations of the above-mentioned financial reporting obligations. BaFin also has to publish any additional information in relation to these decisions such as information as to whether the measures are enforceable, whether appeals have been lodged against

the measures taken by BaFin and what the outcome of these appeal proceedings was.<sup>40</sup>

In 2017, BaFin published information on 11 companies (previous year: 7), detailing the measures taken and the associated comments. These publications make administrative actions much more transparent.

## 6 Supervision of the investment business

### 6.1 Asset management companies and depositaries

In 2017, BaFin authorised 11 asset management companies (*Kapitalverwaltungsgesellschaft*) to manage collective investment undertakings or extended their existing authorisation (previous year: 14). 6 companies surrendered their authorisation (previous year: 2). This meant that, at the end of 2017, 136 companies were authorised in accordance with the German Investment Code (*Kapitalanlagegesetzbuch*) (previous year: 136). In addition, 52 asset management companies (previous year: 50) registered in accordance with section 44 of the Investment Code. 12 companies surrendered their registration, 2 of which applied for authorisation in accordance with the Investment Code. The total

<sup>40</sup> See 7.1 and chapter II 6.

**Table 27: Risk classification of asset management companies**

Asset management companies	Quality				Total
	A	B	C	D	
High	8	1			9
Medium	9	4			13
Low	46	6	2		54
<b>Total</b>	<b>63</b>	<b>11</b>	<b>2</b>	<b>0</b>	<b>76</b>

number of asset management companies registered as at the end of 2017 stood at 314 (previous year: 260).

BaFin observed a general trend towards consolidation in this sector in 2017. This relates primarily to planned mergers and acquisitions of small and medium-sized asset management companies as well as asset management companies belonging to groups.

In 22 cases, asset management companies established a branch in another EU member state or offered cross-border services (previous year: 11). A total of 53 companies from other EU countries notified BaFin that they had established a branch or started providing cross-border services in Germany (previous year: 25).

#### Risk-based supervision

BaFin performed 116 supervisory visits and annual interviews on site (previous year: 102). It accompanied 5 audits and special audits at asset management companies as well as at depositaries and trustees (previous year: 13). The frequency of using such measures in a company is mostly determined on the basis of its risk classification (see Table 27 "Risk classification of asset management companies").

In addition to dealing with negative interest rates in the current interest rate environment and Brexit-related issues, such as investments in the United Kingdom, the supervisory visits and annual interviews conducted in 2017 focused on the following in particular: sustainable and ethical investments, IT security, the impact of cyber risks and climate change on asset management companies and the need for such companies to adapt to legislative changes (for example, the German Investment Tax Act (*Investmentsteuergesetz*), MiFID II, Benchmarks Regulation).

## 6.2 Collective investment undertakings

The German investment market remained robust and continued to grow in 2017. This benefited open-ended retail funds as well as special funds, both of which recorded cash inflows.

At the end of 2017, the asset management companies managed a total of 6,449 open-ended investment funds (previous year: 6,122) with assets amounting to €2,062 billion (previous year: €1,908 billion). Of these funds, 2,417 (previous year: 2,194) were retail funds with assets totalling €498 billion (previous year: €451 billion) and 4,032 (previous year: 3,928) were special AIFs<sup>41</sup> with assets of €1,564 billion (previous year: €1,457 billion).

Aggregate (net) cash inflows into retail and special funds amounted to €94.9 billion (previous year: €119.96 billion). (Gross) cash inflows amounted to €331.7 billion (previous year: €310.3 billion), of which €115 billion was attributable to retail investment funds (previous year: €106.8 billion) and €217 billion to special AIFs (previous year: €203.5 billion). This was set against cash outflows totalling €236.8 billion (previous year: €190.3 billion).

In 2017, BaFin approved a total of 138 new retail investment funds in accordance with the Investment Code (previous year: 151), including 107 UCITS<sup>42</sup> (previous year: 99), 7 open-ended retail AIFs (previous year: 12) and 24 closed-ended retail AIFs (previous year: 40).

<sup>41</sup> Alternative investment funds.

<sup>42</sup> UCITS stands for "undertakings for collective investment in transferable securities". UCITS are funds that meet the requirements of the UCITS Directive (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).

## 6.2.1 Open-ended real estate funds and hedge funds

The number of asset management companies authorised to manage open-ended real estate funds was steady at 58. 1 company received its authorisation in 2017 and 1 surrendered it.

While 21 asset management companies had also established open-ended real estate funds for retail investors (previous year: 22), 37 companies had limited their activities to the management of open-ended real estate special funds (previous year: 36). Of this number, 4 companies have to date not established any open-ended real estate funds.

3 open-ended real estate funds for retail investors were established and 1 open-ended real estate funds for retail investors was liquidated in the course of 2017, increasing the total number of these funds to 53 (previous year: 51). The fund volume of this market segment amounted to €92.33 billion as at the end of the year (previous year: €89.48 billion).

In 2017, gross cash inflows into open-ended real estate funds for retail investors amounted to €7.9 billion, the same as in the previous year. Gross cash inflows into open-ended real estate special funds increased for the seventh year in succession, to €16.2 billion (previous year: €14.9 billion). The fund assets of open-ended real estate special funds amounted to €88.2 billion at the end of 2017 (previous year: €75.6 billion).

21 open-ended real estate funds for retail investors were in liquidation at the end of 2017 (previous year: 20). Their fund volume amounted to €3.92 billion (previous year: €8.2 billion). The management rights for 19 of these funds have already been transferred to the depositary (previous year: 14).

There were 14 hedge funds in Germany at the end of 2017 (previous year: 14). The total volume under management was €3.43 billion (previous year: approximately €3.02 billion). As in the previous year, there were no German funds of hedge funds in Germany in 2017.

## 6.2.2 Experience with the supervision of closed-ended funds

As a result of the introduction of the Investment Code in summer 2013, managers of closed-ended investment funds were placed under close government supervision for the first time. The aim was to provide better

protection to investors against irregularities, such as inadequate product transparency, insufficiently qualified personnel and gaps in the organisation of providers. This marked the beginning of a new supervisory regime for both the sector concerned and investment supervision at BaFin.

### Interpretive decisions

The Investment Code, the statutory orders issued under this code and the German Regulation Implementing the AIFM Directive (*Durchführungsverordnung zur AIFM-Richtlinie*) contain a large number of detailed rules for asset management companies and closed-ended alternative investment funds (AIFs), especially if they are intended for marketing to retail investors. Nevertheless, BaFin had to make decisions on many interpretive issues and develop suitable standards for establishing an effective administrative practice. This will add to the complexity of the consultation processes between BaFin and applicants until a viable solution is found, although these processes are becoming increasingly more efficient over time.

### Growing acceptance

Among the companies that have been placed under supervision as a result of the Investment Code, the initial reservations about being supervised by BaFin have given way to growing acceptance. Contributing factors have been regular informal exchanges at the working level and supervisory interviews with senior management, which are held at least once a year. In addition, many companies have come to realise that the transition to professional processes, clear structures and meticulous documentation pays off, not only in their dealings with BaFin.

However, BaFin also found that some companies still have to work on their professionalism and business philosophy. For example, a few small asset management companies are unable to find adequate access to target investments or investors. BaFin has also observed major differences in the quality of depositaries, including alternative (trustee) depositaries, the legal advice provided by the companies and the reports produced by the auditors of annual financial statements.

In smaller asset management companies that only apply for registration, it is hard to identify any shortcomings, because the level of supervision prescribed by law is not sufficient. However, significant differences in quality compared with authorised asset management companies are revealed at the latest when a special audit is conducted or an application to convert the registration to full authorisation is reviewed.

### Senior management

BaFin also subjects candidates for senior management positions to particular scrutiny. For companies, it is often difficult to recruit appropriately qualified and experienced people who are able to accept the high level of responsibility for protecting the interests of investors. Since, during the times of the unregulated capital market, these companies normally did not practice any risk management that would have come anywhere close to the standards of the Investment Code, the candidates would have had to gain the required operational experience in institutions governed by the Banking Act<sup>43</sup> or through relevant audit activities, for example. However, BaFin and the companies are increasingly able to agree on tailored induction and transitional solutions which the supervised companies can ultimately see as a success.

### Large number of business models

In addition to the legal pioneering work during the early years of the Investment Code, the supervision of closed-ended funds was also shaped by the analysis of a large number of specialisations, asset skills, product lines, corporate structures and service relationships. BaFin also gained valuable insights by shadowing special on-site inspections, sometimes even at external service providers abroad, in order to develop a first-hand understanding of the work processes and the external conditions around them. This approach also shows up inconsistencies between the documents submitted and reality.

We will be in a better position to measure the extent to which regulation under the Investment Code leads to better products for investors in a few years' time, when the first closed-ended AIFs launched under the Investment Code have been liquidated. BaFin has no way of checking whether the decisions taken by asset management companies make financial sense. But it defines the outer framework of their business and encourages perception in the market by enforcing transparency requirements. Where there are signs of conflicts of interest and non-market-based costs or valuations, BaFin will intervene.

## 6.2.3 Foreign collective investment undertakings

In 2017, there were 10,183 EU UCITS authorised for marketing (previous year: 9,795). BaFin processed a total of 1,006 new notifications by companies wanting to

<sup>43</sup> See the German Banking Act (*Kreditwesengesetz*).

market EU UCITS in Germany (previous year: 941). As in previous years, most of the notifications – 592 in total – came from Luxembourg. In addition, 276 notifications were received from Ireland, 52 from Austria and 45 from France. Marketing was discontinued for 565 EU UCITS.

In addition, 1,591 EU AIFs and 285 foreign AIFs from third countries were authorised to conduct marketing in Germany (previous year: 1,402 EU AIFs and 266 foreign AIFs from third countries). Of the total number, 885 originated in Luxembourg, 269 in the United Kingdom, 234 in Ireland, 101 in the United States, 91 in the Cayman Islands, 72 in France, 45 in the Netherlands and 2 in Switzerland. In 2017, marketing for 553 AIFs (previous year: 525) started in Germany, including 287 from Luxembourg, 74 from the United Kingdom, 51 from Ireland, 39 from the United States and 17 from the Cayman Islands. 184 EU AIFs and foreign AIFs ceased marketing, including 56 from Luxembourg, 46 from the United Kingdom and 25 from Ireland.

## 7 Administrative fine proceedings

### 7.1 Administrative fines<sup>44</sup>

In 2017, BaFin initiated 188<sup>45</sup> new administrative fine proceedings (2016: 281; see Table 28 "Administrative fine proceedings" on page 158). A total of 981 proceedings were still pending from previous years. BaFin completed 300 proceedings, 96 of them by imposing a fine (previous year: 106). This translates into a prosecution ratio of 32 percent (previous year: 27.6 percent). A total of 204 proceedings were discontinued, 177 of them for discretionary reasons. BaFin imposed administrative fines of approximately €5.64 million (previous year: €2.57 million).<sup>46</sup> The highest single fine imposed amounted to €668,000.

<sup>44</sup> 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 German Securities Trading Act (*Wertpapierhandelsgesetz*) and violations of the German Banking Act (*Kreditwesengesetz*), see chapters II 2.4.3 and II 6.

<sup>45</sup> The figures quoted refer to the aggregate of all administrative fine proceedings pursued in Securities Supervision.

<sup>46</sup> The total amount of administrative fines imposed includes the administrative fine proceedings presented in chapter II 6.

**Table 28: Administrative fine proceedings**

	Proceedings pending at the beginning of 2017	New proceedings initiated in 2017	Administrative fines*	Highest administrative fine imposed** (€)	Proceedings discontinued for factual or legal reasons	Proceedings discontinued for discretionary reasons	Proceedings pending at the end of 2017
Transaction reporting requirements	9	2	2	25,000			9
Ad hoc disclosures	82	22	11	250,000		10	83
Market manipulation	36	7	8	42,000	1	2	32
Notification and publication requirements (part 5 of the Securities Trading Act)	567	57	56	375,000	11	112	445
Duties to provide information to securities holders (part 5a of the Securities Trading Act)	37	2	2	26,600	2	9	26
Financial reporting requirements	131	78	10	668,000	9	22	168
Company takeovers (Securities Acquisition and Takeover Act)	18	1	1	17,000	1	7	10

\* Proceedings completed by imposing an administrative fine.

\*\* Individual administrative fines.

Since the end of 2016, BaFin has had to publish measures and sanctions<sup>47</sup> on its website, [www.bafin.de](http://www.bafin.de).<sup>48</sup> It disclosed 8 administrative fine decisions in 2017, of which 7 related to compliance with financial reporting requirements.<sup>49</sup>

## 7.2 Selected cases

### Intentional violation of the obligation to publish ad hoc disclosures

BaFin imposed an administrative fine of € 92,000 on a TecDAX company, which had intentionally failed to publish inside information in a timely manner. Although on the eve of the publication of the ad hoc disclosure,

the Management Board considered the agreement in principle with the other party to the contract to be inside information, it did not publish this information immediately, but the following morning.

### Violations of the transaction reporting requirements

BaFin imposed an administrative fine of € 25,000 on an investment firm, which over a period of more than two months had failed in a negligent manner to report approximately 70,000 transactions in financial instruments to BaFin in accordance with section 9 (1) of the Securities Trading Act. The reports were not transmitted during that period because of a technical modification of the connection to the stock exchange system. The company reported the transactions only subsequently, after BaFin had contacted it. It had failed to check after its system changeover whether reports in accordance with section 9 (1) of the Securities Trading Act were still being sent to BaFin.

<sup>47</sup> For information on the distinction between measures and sanctions, see the 2016 Annual report, p. 55 ff.

<sup>48</sup> This new practice is based on the European Transparency Directive II (Directive 2013/50/EU, OJ EU L 294/13) and the Market Abuse Regulation (MAR, Regulation EU No 596/2014, OJ EU L 173/1). See 2016 Annual Report, page 200.

<sup>49</sup> See 5.

### **Violations of the voting rights notification requirements**

Due to a negligent breach of its duty of oversight in connection with six violations of the voting rights notification requirement, BaFin imposed an administrative fine of € 100,000. The company concerned had failed to ensure through suitable oversight measures, such as the dual control principle and adequate internal controls, that accurate voting rights notifications were provided to issuers and BaFin in a timely manner.

### **Violations of the Securities Acquisitions and Takeover Act**

BaFin imposed an administrative fine of € 17,000 on a natural person who had failed to disclose to the public in a timely manner that they had gained control over a target company. The offeror had had control over the target company for more than six months before publishing information about gaining control when prompted by BaFin.



**VI**

About BaFin

An abstract graphic consisting of numerous thin, white, wavy lines that flow from the top right towards the bottom left, creating a sense of movement and depth against the solid red background.



# 1 Human resources

**A**s at 31 December 2017, a total of 2,602 employees (previous year: 2,552) worked at BaFin's offices in Bonn (1,893) and Frankfurt am Main (709). Approximately 76.48 percent (1,990) were civil servants (*Beamte*) and approximately 23.52 percent (612) were public service employees covered by collective wage agreements (*Tarifbeschäftigte*) and others not covered by collective wage agreements (see Table 29 "Personnel").

Women represented around half of BaFin's employees, accounting for 47 percent (1,223). 78 employees were on long-term assignment to international institutions and supervisory authorities as at 31 December 2017, of whom 36 were working temporarily as delegates to the European Central Bank (ECB).

## A total of 118 new staff recruited

In 2017, BaFin recruited a total of 118 new members of staff, 38 more than in the previous year (see Table 30 "Recruitment in 2017" on page 162). The majority of the new recruits were fully qualified lawyers and economists, but they also comprised 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, vocational trainees for the intermediate civil service and temporary staff.

## Career entry at BaFin

Those starting their careers at BaFin may undergo preparation for the higher intermediate civil service or complete vocational training in the intermediate civil service, among other options. At the end of 2017, BaFin

had a total of 43 vocational trainees and candidates for entry to the higher intermediate civil service, compared with 57 in the previous year.

As at December 2017, 18 students (previous year: 26) were enrolled as candidates for entry to the higher intermediate civil service on the "Central Banking" degree programme offered by the Deutsche Bundesbank University and one student on the information technology for public administration degree programme at the Federal University of Applied Administrative Sciences. Five of those students (previous year: four) began their studies during the year under review.

Nine persons commenced their vocational training in 2017 (previous year: eight). At the end of 2017, BaFin had completed training for a total of 24 vocational trainees (previous year: 31) in the following career profiles: administration specialists, IT specialists for system integration, business administration specialists for office management and media and information services specialists, specialising in librarianship.

## Expertise through CPD

BaFin attaches great importance to broadening and further developing its employees' knowledge and skills and keeping them up-to-date on an ongoing basis. In 2017, BaFin employees took part in 656 continuing professional development (CPD) events (previous year: 673). The total number of attendances at such events was 4,029 (previous year: 4,037). On average, each BaFin employee attended a CPD session on 3.0 days (previous year: 3.1 days).

Whether for beginners, more advanced participants or experts: BaFin provides CPD sessions in a wide range of specialist areas to strengthen employees'

**Table 29: Personnel**

As at 31 December 2017

Career level	Employees			of which civil servants	of which public service employees
	Total	Female	Male	Total	Total
Higher civil service	1,238	503	735	1,143	95*
Higher intermediate civil service	822	360	462	690	132
Intermediate/basic civil service	542	360	182	157	385
<b>Total</b>	<b>2,602</b>	<b>1,223</b>	<b>1,379</b>	<b>1,990</b>	<b>612*</b>

\* Including those employees not covered by collective wage agreements.

**Table 30: Recruitment in 2017**

Career level	Total	Female	Male
<b>Higher civil service</b>	70	31	39
Qualifications:			
Fully qualified lawyers	34		
Economists	22		
Mathematicians/ statisticians	7		
Other	7		
<b>Higher intermediate civil service</b>	40	18	22
Qualifications:			
Business lawyers	5		
Economists	23		
Career training	2		
Other	10		
<b>Intermediate/ basic civil service</b>	8	2	6
<b>Candidates for entry to the higher intermediate civil service/ vocational trainees</b>	14	7	7
<b>Total</b>	<b>118*</b>	<b>51*</b>	<b>67*</b>

\* Excluding candidates for entry to the higher intermediate civil service/ vocational trainees.

expertise and soft skills. The CPD activities focus on the specific requirements for individual areas and also on interdisciplinary topics. Joint training initiatives, in particular with the Deutsche Bundesbank, the European Central Bank (ECB) and the European Supervisory

Authorities (ESAs), promote closer collaboration and more effective international networking.

## 2 Budget

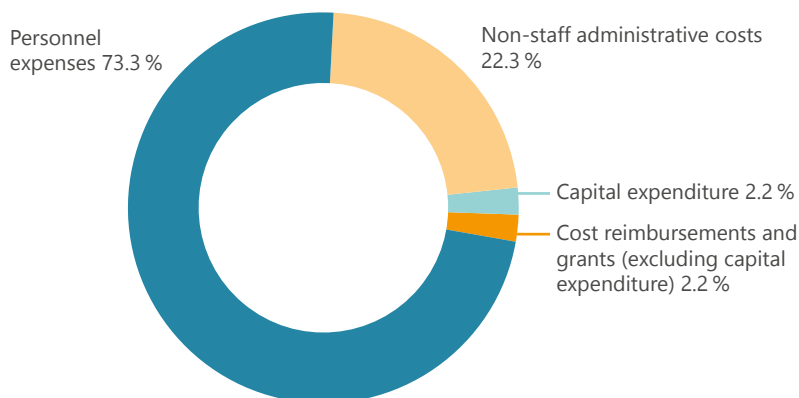
BaFin's Administrative Council approved a budget of €285.5 million for 2017 (previous year: €262.8 million). Personnel expenses accounted for around 73.3 percent of the projected expenditure (€209.3 million; previous year: €190 million) and non-staff costs for around 22.3 percent (€63.5 million; previous year: €55.9 million). Capital expenditure represented 2.2 percent of the budget (previous year: 4.2 percent). Cost reimbursements and grants were unchanged at the previous year's level of 2.2 percent of the budget (see Figure 19 "2017 budget expenditure").

### Financing through cost allocations and fees

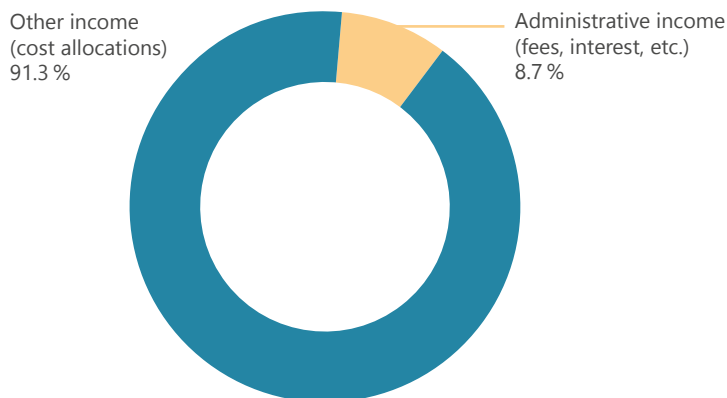
BaFin is independent of the federal budget and is fully self-financed from its own income. The largest proportion of this in the 2017 budget was attributable to cost allocations levied on the supervised undertakings, a special levy with a financing function (projected figure for 2017: €260.6 million; previous year: €236.3 million). BaFin also generates administrative income such as fees and interest (projected figure for 2017: €24.9 million; previous year: €26.5 million; see Figure 20 "2017 budget income" on page 163).

The final cost allocation for 2016 was performed in 2017. The banking industry accounted for 47.4 percent of the total income from cost allocations. The insurance sector contributed 26.7 percent and the securities trading sector 25.9 percent. The cost allocation for 2017 will take place during the course of

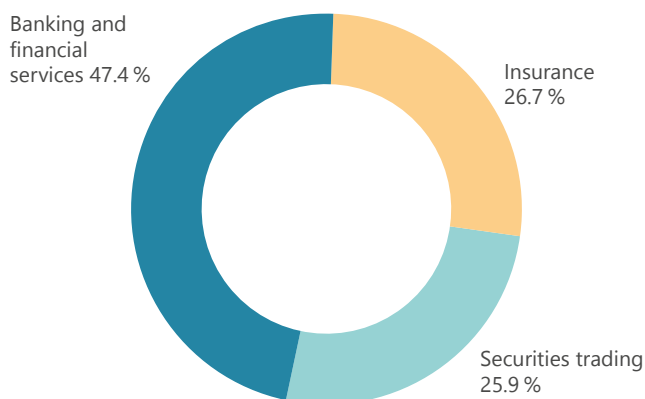
**Figure 19: 2017 budget expenditure**



**Figure 20: 2017 budget income**



**Figure 21: Cost allocations by supervisory area in 2016**



2018 (see Figure 21 “Cost allocations by supervisory area in 2016”).

**Actual expenditure/income**

BaFin’s actual expenditure in 2017 was approximately € 279 million (previous year: € 248 million). This is around € 6.4 million less than the figure reported in the budget. This was set against income of around € 282.5 million (previous year: € 261.5 million). BaFin’s Administrative Council had not yet approved the 2017 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 2017 (previous year: € 8.2 million). This included a planned 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 € 7.9 million (previous year: € 7.8 million), while income – including advance cost allocation payments for 2018 – amounted in total to approximately € 16.5 million (previous year: € 14.7 million).

## 3 New Resolution Directorate

BaFin is also the national resolution authority as from 1 January 2018. The new Directorate has taken over the resolution functions of the Federal Agency for Financial Market Stabilisation (FMSA). The Directorate is headed by Dr Thorsten Pöttsch.

By transferring the resolution function to BaFin, the new legislation has given it responsibility for an additional, significant area of activity. BaFin President Felix Hufeld welcomed the assumption of the new function in his speech at BaFin's New Year press reception.<sup>1</sup> While remaining independent, the resolution and supervisory activities benefitted from operating alongside each other under one roof, he said, adding that this was simply a more efficient way of working. "If a bank gets into difficulties, it will now be easier for us to restructure it or – if necessary and the preconditions are met – to resolve it and so avert damage from the general public", he said in his summary. As the national resolution authority, BaFin now also forms part of the Single Resolution Mechanism (SRM).

The Authorisation Requirement and Enforcement relating to Unauthorised Business department and the units of the department for the prevention of money laundering that are not engaged in operational supervision and are therefore not in conflict with the resolution function have also been allocated to the Resolution Directorate.<sup>2</sup>

## 4 Compliance

### Code of conduct for the members of the Executive Board

A new code of conduct, agreed with the Federal Ministry of Finance (*Bundesfinanzministerium*) in 2017 and published online, brings together the conduct of business rules applying to BaFin's Executive Board. These conduct of business rules are derived from the German Act Establishing the Federal Financial Supervisory Authority (*Gesetz über die Bundesanstalt für Finanzdienstleistungsaufsicht*), the German Federal

### Definition

### Central Compliance responsibilities

The Central Compliance Office (ZC) brings together the officer functions for data protection, occupational safety, the prevention of corruption, employee transactions, sponsoring, business continuity management (BCM) and for crisis and disaster management. It takes preventive measures with the aim of ensuring that all BaFin units comply with the statutory requirements. The office performs compliance functions for the Executive Board and provides advice to BaFin's employees. The office's responsibilities also include the implementation of the requirements relating to secondary activities and rewards and gifts, as well as occupational health and safety.

Civil Service Act (*Bundesbeamtengesetz*), the contractual provisions and BaFin's internal guidelines, among other sources.

The code of conduct contains rules on the acceptance of gifts, on lecturing activities and honorary positions and in particular on private securities transactions. For example, the code of conduct provides that the President and the Chief Executive Directors may not carry out transactions in securities of companies within the financial sector. This is audited by an external auditor to ensure that it is subject to independent control.

Since 1 January 2018, a compliance officer within the Central Compliance Office (ZC; see info box "Central Compliance responsibilities") has advised the members of the Executive Board on the rules of good conduct laid down in the code of conduct and has received their notifications under the code of conduct.

### Ethics Framework

Central Compliance coordinates compliance with the Ethics Framework for the Single Supervisory Mechanism issued in 2015. The framework is addressed to the national competent authorities (NCAs), and therefore to BaFin among others, and the national central banks (NCBs) of the member states participating in the Single Supervisory Mechanism (SSM). It lays down uniform minimum standards relating to the compliance activities and corporate governance of the NCAs and NCBs.

In addition, BaFin has installed electronic reporting systems enabling employees to comply with their

1 [www.bafin.de/dok/10361936](http://www.bafin.de/dok/10361936) (only available in German).

2 The organisation charts can be found in the Appendix on pages 171 ff.

obligations relating to notifications and requests for permission for the acceptance of rewards and gifts, as well as the legal requirements governing secondary activities.

## 5 Risk management

BaFin's risk manual entered into force on 26 July 2017. It combines all of the organisational rules, functions and tools of BaFin's internal risk management system.

BaFin's Executive Board had resolved at the start of 2016 to establish an integrated risk management system, covering all of BaFin's risks and bringing together the functions and processes of existing units within the organisation specialising in risk-related issues (e.g. IT security, compliance, internal control system). This integrated approach provides a general overview of the risks of all the Directorates.

Previously, different types of risk were assessed and managed separately in the individual organisational units specialising in risk-related issues. In order to avoid redundancies, moreover, these risks will continue to be identified, evaluated and documented in the relevant organisational units. Specific statutory provisions or standards will apply to these individual components. However, risks assessed as having a particularly high loss potential despite their risk treatment must now be passed on to BaFin's central risk management function. In addition, the central risk management function identifies and manages particularly important risks relating to specific Directorates and risks relating to the whole of BaFin.

## 6 E-government

### E-purchasing and e-invoicing

In 2017, BaFin set up an electronic procurement platform and is using it increasingly to conduct procurement procedures. It enables BaFin to handle all Europe-wide procurement procedures electronically well in advance of the implementation date<sup>3</sup> prescribed by the legislation.

BaFin is also establishing a largely standardised and efficient workflow-based system for electronically

<sup>3</sup> Directive (EU) 2014/24/EU, OJ EU L 94/65.

### Definition

#### XBRL

XBRL stands for eXtensible Business Reporting Language and is an XML-based (Extensible Markup Language)<sup>4</sup> standard which automates and standardises the exchange of data between two parties. The data are specified in taxonomies. A taxonomy is a catalogue in which elements are defined which can make up an XBRL data package. In addition to the actual format, such as the type of data, the definition also includes rules for checking data consistency. Thus, media discontinuity and the manual capture of financial data can be avoided.

supported invoice processing. This means that it is complying with the statutory requirements of the Directive on electronic invoicing in public procurement.<sup>5</sup>

### Automated data exchange

BaFin uses the XBRL standard for the automatic exchange of business and financial data with supervised entities (see info box).

BaFin applied this standard for the first time with the entry into force of the Solvency II Directive on 1 January 2016. The European Insurance and Occupational Pensions Authority (EIOPA) had developed a corresponding XBRL taxonomy for this purpose, which is used both by the insurance undertakings being supervised and by the national supervisory authorities.

This results in a high number of valid notifications from the beginning. The automated processing at BaFin generally takes a few minutes. These processing times have proved to be very good in a European comparison.

BaFin is currently giving consideration to its own national taxonomy and is also making preparations for further deliveries of data on an XBRL basis.

### Analytic data warehouse

The availability of large quantities of data (big data) requires new approaches to enable appropriate information to be extracted from them. BaFin has therefore introduced an analytic data warehouse (ADW),

<sup>4</sup> XML is a machine-readable language for presenting hierarchically structured data in the form of a text file.

<sup>5</sup> Directive (EU) 2014/55/EU, OJ EU L 133/1.

which is a scalable high-end in-memory database architecture. The ADW enables data to be analysed and evaluated almost in real time. Additionally, BaFin has begun the use of a visualisation software programme and initial artificial intelligence (AI) techniques.

### **Project ALMA**

March 2017 saw the start of the interdisciplinary project known as the automated alarm and market monitoring system (ALMA). This uses the ADW as well as the visualisation software and initial AI techniques. For the automated identification of cases of insider trading in securities, ALMA extracts price-relevant information from ad hoc announcements and performs a variety of pattern recognition functions.

The ALMA project does not integrate new requirements in the context of a traditional concept phase. All of the participants engaged in this project within BaFin form part of a learning process in handling the data and are working out requirements, proto- and pseudocodes and indicators on an interdisciplinary basis.

The information required is described formally in a structured query language (SQL) so that it is located by the database system of the ADW in the gigantic volume of data in an optimised reaction time. For the data analysts in the relevant divisions, these indicators<sup>6</sup> and SQLs form the basis for learning about ordinary trading activities from the system. This enables irregularities to be identified automatically and to be used to support the decision-making process.

ALMA integrates these algorithms and techniques in a single, intuitive visual interface for users at BaFin. The data transmitted to BaFin are stored in the ADW for this purpose via a number of process stages. The volume of data will be multiplied further in future as a result of new regulations coming into force.

## **7 Communications**

### **7.1 Press enquiries**

In 2017 as in previous years, BaFin received several thousand enquiries from journalists relating to its various areas of responsibility.

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<sup>6</sup> The indicators include, for example, events such as date, actor and price and arithmetical variables such as mean values and significances.

### **Brexit**

Many journalists once again sought information about the consequences of Brexit during the year. Companies based in the United Kingdom – including many subsidiaries of major non-European banks – are expected to lose their EU passporting rights. BaFin has already held discussions with more than 100 companies considering relocating to Germany so that they can continue to use their passporting rights.

### **Digitalisation**

The subject of banks' IT security created great interest in the media. Many journalists wanted to know about the requirements for the institutions' IT security and whether the arrangements already in place fulfil these criteria.

Crypto tokens, in particular bitcoins, kept the press very busy in 2017. The focus was on consumer protection issues and regulation, especially the authorisation requirement.

The new phenomenon of initial coin offerings (ICOs), on which BaFin was one of the first supervisory authorities worldwide to issue a consumer warning<sup>7</sup> in November 2017, also met with great interest.

Many press inquiries also related to the implementation of the Second Payment Services Directive (PSD2). Journalists focused in particular on the security aspects relating to the authorisation of third-party service providers and customer authentication.

The establishment of a division for innovations in financial technology was also covered in the media.

### **Finalisation of Basel III**

The media also showed lively interest in the negotiations relating to the final work on Basel III, the global regulatory framework for banks. Questions related to positions on the output floor and the possible consequences for the institutions.

### **MiFID II**

In addition, the media paid great attention to the requirements of the European Markets in Financial Instruments Directive II (MiFID II) and its transposition into German law. Journalists' questions mainly related to the new focus of the regulation on the whole of the product cycle.

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<sup>7</sup> [www.bafin.de/dok/10185906](http://www.bafin.de/dok/10185906).

### Product intervention

BaFin's first product intervention measure also attracted the attention of the media. In the middle of the year, BaFin used the option of product intervention for the first time and restricted the marketing, distribution and sale of contracts for difference (CFDs). Press representatives were also interested in the fact that BaFin decided not to prohibit the distribution of credit-linked notes and continues to monitor the voluntary undertaking of the German Banking Industry Committee (*Deutsche Kreditwirtschaft*) and the German Derivatives Association (*Deutscher Derivate Verband*).

### Deutsche Börse AG

The public prosecutor's proceedings relating to the CEO of Deutsche Börse AG and other members of management were also the subject of a large number of press inquiries. Journalists wanted to know what role BaFin was playing in the investigations into insider trading and how it was working together with the prosecuting authorities. They were also interested in the legal aspects of the offence of insider trading. The question of the reliability of a CEO was also raised.

### Low interest rates and run-off

The persisting low interest rate environment was also one of the central topics for the media. In addition to the general position of the life insurance industry and the build-up of the additional interest provision (*Zinszusatzreserve*), the press also focused increasingly on the situation of the *Pensionskassen*. The results of the EIOPA stress test for institutions for occupational retirement provision were of particular interest in this context.

The media also addressed the subject of external run-off, after a number of life insurance undertakings revealed that they were considering the possibility of divesting themselves of legacy portfolios. Journalists were keen to find out what supervisory requirements would apply to the sale of an undertaking or the transfer of a portfolio, and how BaFin was ensuring that the interests of policyholders would be protected in the event of an external run-off.

### Solvency II

The European Solvency II framework, which came into force at the start of 2016, was once again a dominant topic in the press. Questions on the subject related to the first-time publication of the insurers' solvency and financial condition reports (SFCR), among other issues.

### Basic payment account and contact point for whistleblowers

With respect to the basic payment account, media representatives wanted to know how many applications to open an account had been refused without justification each year since the introduction of the legal right to a bank account, and how BaFin was dealing with the situation.

The press were also very interested in the introduction of an anonymous two-way communications tool for the contact point for whistleblowers in January 2017, particularly as BaFin received around twice the number of tipoffs via this channel as previously.

## 7.2 Events and trade fairs

### Forum on "White-collar Crime and the Capital Market"

On 9 and 10 November 2017, BaFin hosted its annual forum on "White-Collar Crime and the Capital Market" for the 14th time. The participants consisted of around 400 representatives of the police and the public prosecutor's office, as well as representatives 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 digital white-collar crime and on price determination on the stock exchanges.

### BaFin conference on the new Payment Services Directive

BaFin also hosted a conference, held on 5 December 2017, on the effect of the new Payment Services Directive (PSD2) on payment services in the conflict between digitalisation and security requirements. At this event, BaFin together with the Federal Ministry of Finance provided insights into current developments at national and international level, and informed those attending about the supervisory requirements for security in payment services.

### MiFID II conference

BaFin held a conference on 27 October 2017 for representatives of the entities under its supervision, dealing with the implementation of the MiFID II requirements relating to the conduct of business rules. Around 375 participants obtained information about the most important changes in the conduct of business rules.

### Workshop on "IT Supervision in the Banking Sector"

On 16 March 2017, representatives of the finance industry and IT security experts gathered at BaFin's invitation for its workshop on "IT Supervision in the Banking Sector". Around 400 participants brought

themselves up-to-date on current supervisory issues relating to IT supervision in the banking sector. The major topics were the supervisory requirements for IT in financial institutions and PSD2.

#### **Information for investors**

In April 2017, BaFin took part in the "Invest" trade fair in Stuttgart, providing information for investors. Talks given by BaFin representatives informed investors about

credit-linked notes, structured products and contracts for difference (CFDs), among other things, and showed them what to bear in mind when buying these products.

Last but not least, BaFin was represented and provided information at the *Börsentage* in Berlin, Dresden, Munich and Hamburg as well as at the Federal Ministry of Finance's open house in Berlin.

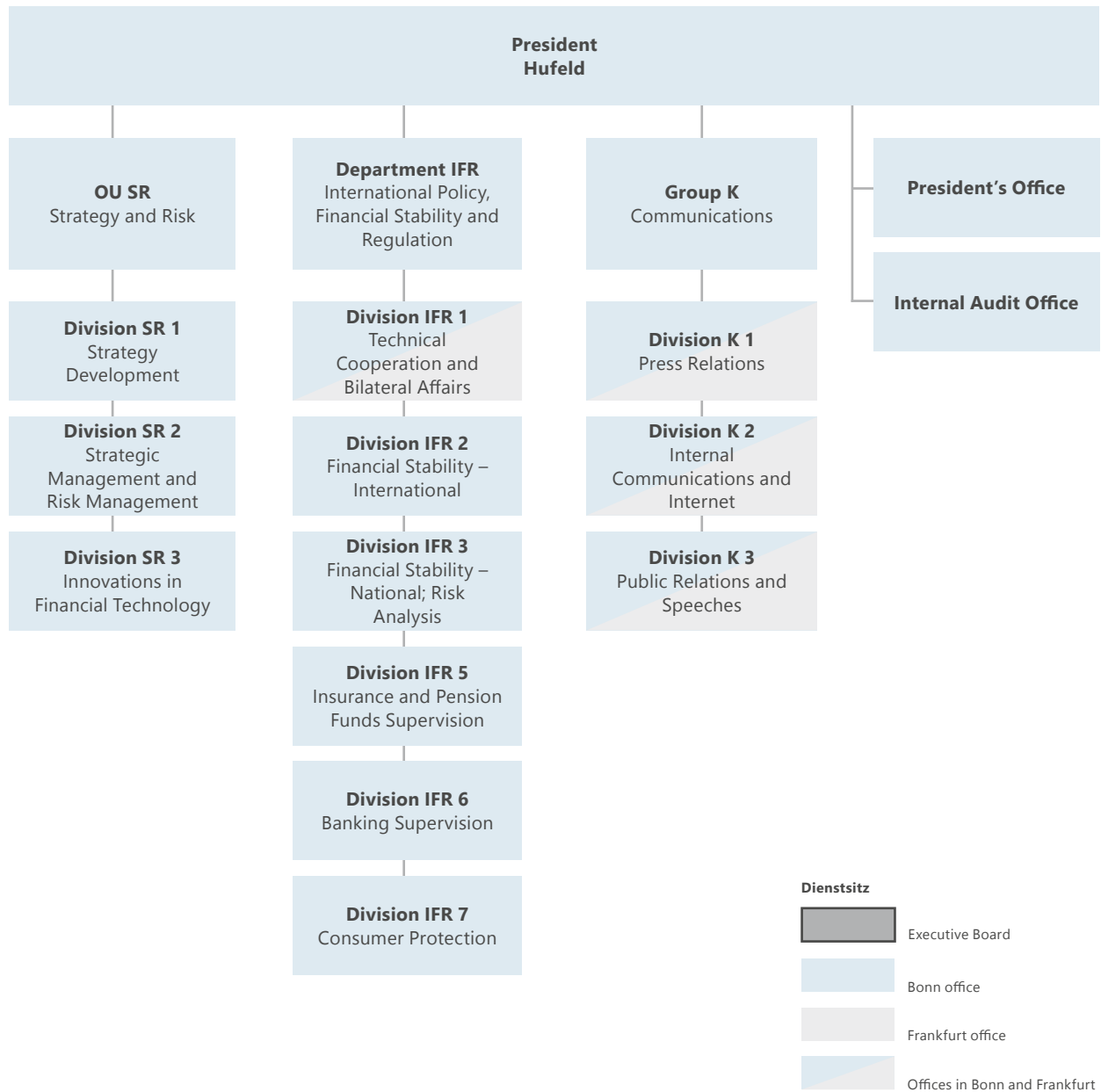




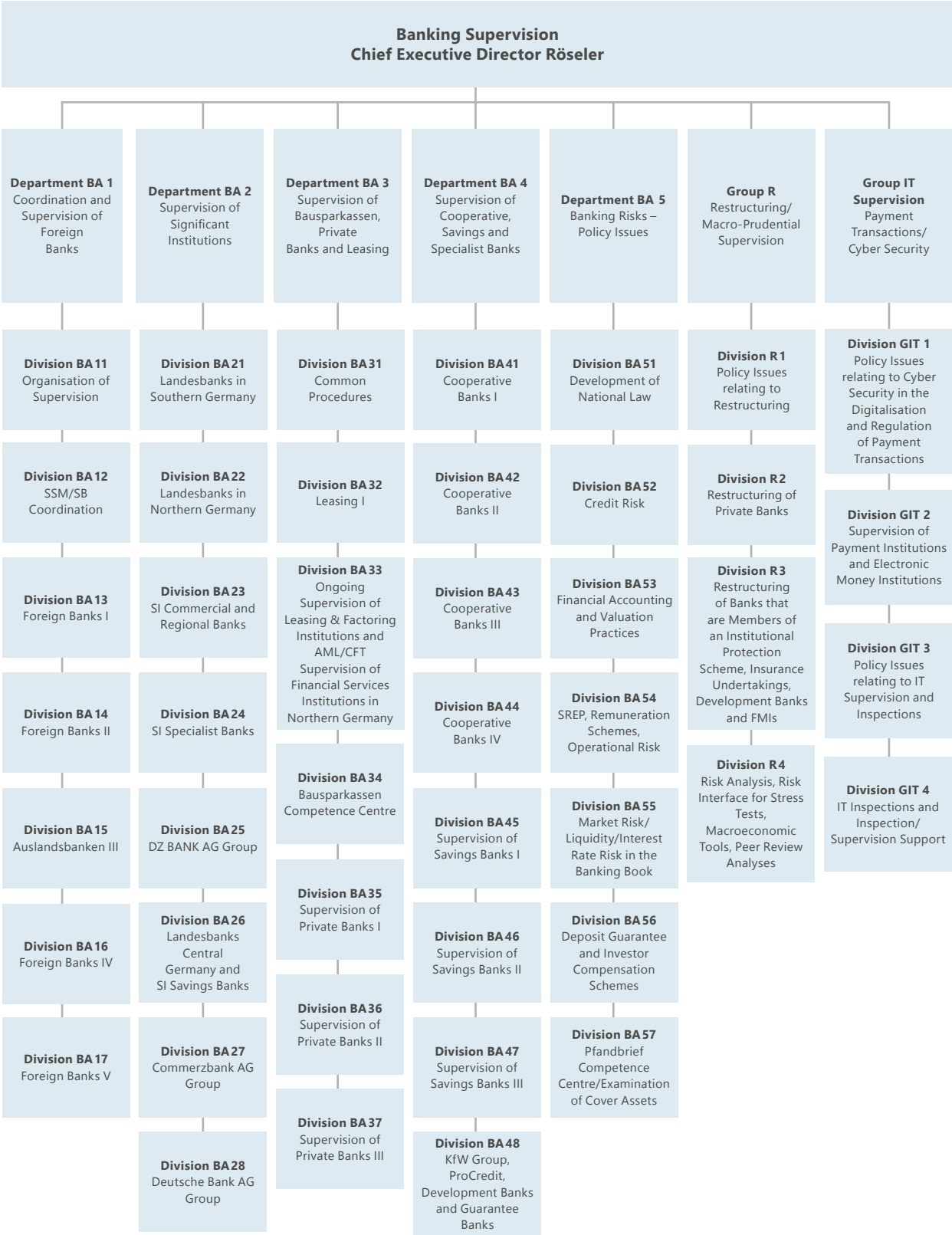
# Appendix



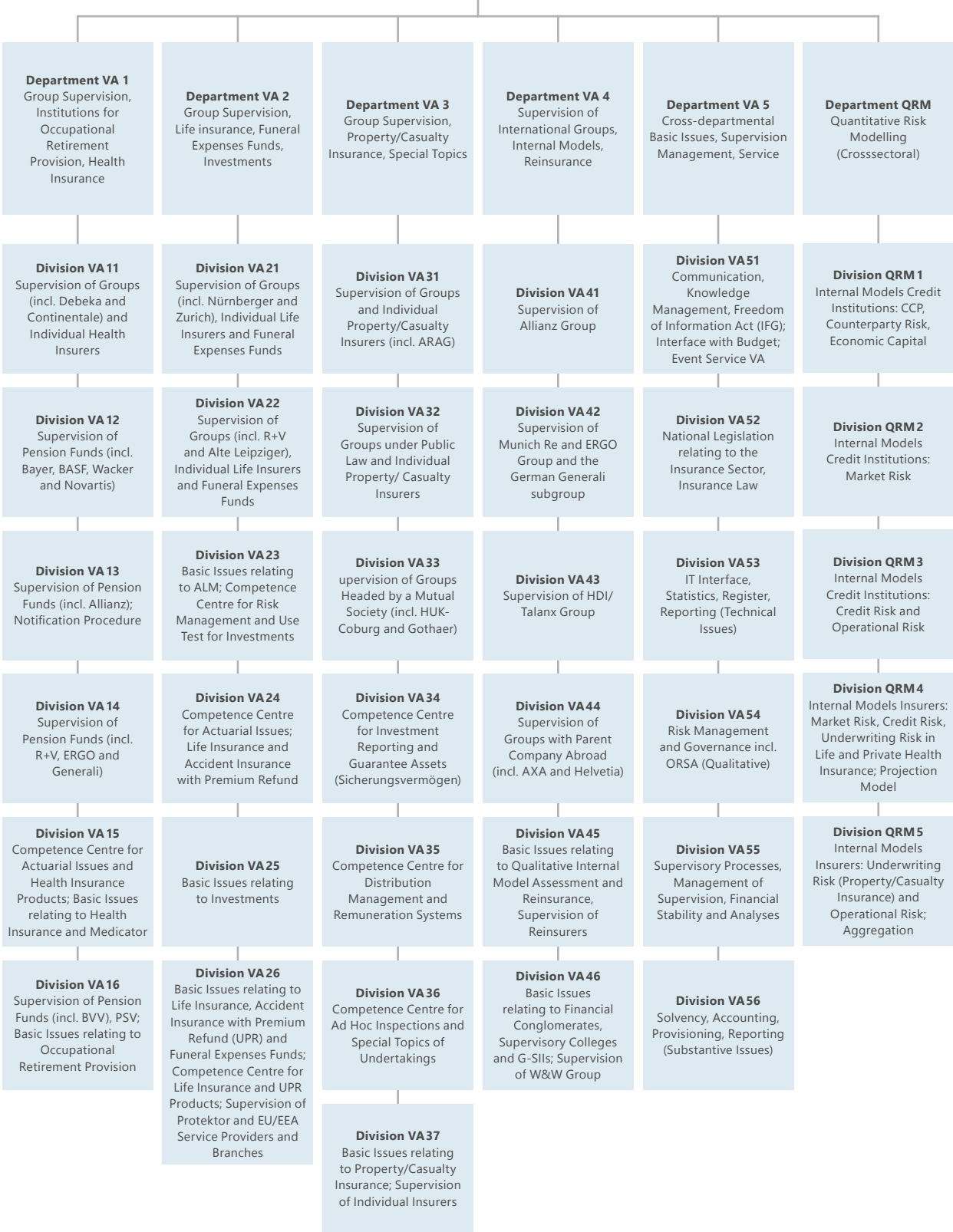
# 1 Organisation chart\*



\* As at: February 2018



**Insurance and Pension Funds Supervision**  
**Chief Executive Director Dr Grund**

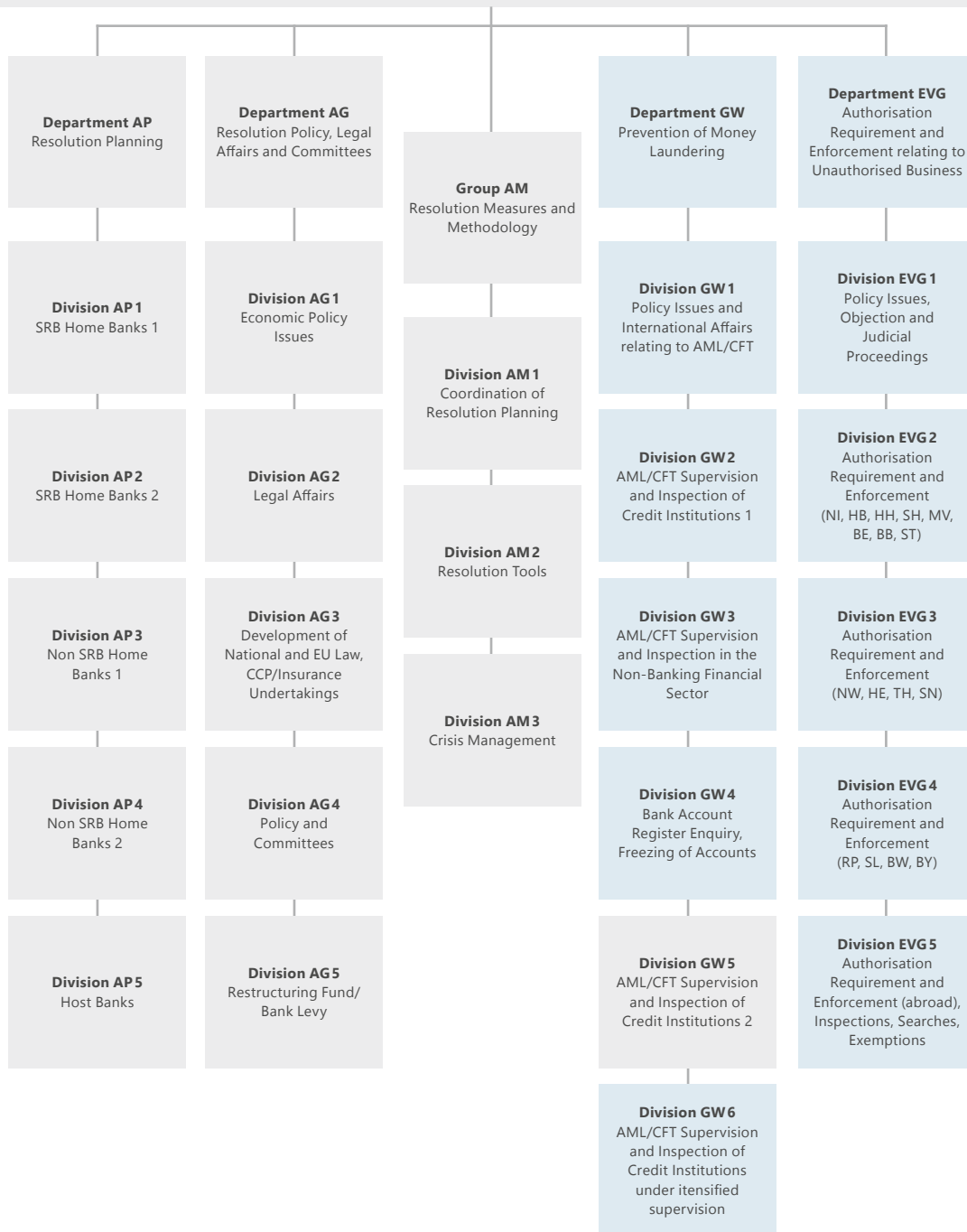




**Internal Administration and Legal Affairs  
Chief Executive Director Freiwald**



**Resolution Directorate**  
Chief Executive Direktor Dr Pötzsch





## 2 BaFin bodies

### 2.1 Members of the Administrative Council

#### **Representing Federal Ministries**

Dr Thomas Steffen (Chair)  
Dr Levin Holle (Deputy Chair)  
Dr Eva Wimmer  
Dr Raphael L'Hoest  
Erich Schaefer  
Helga Springeneer

#### **Representing the Bundestag**

MdB Klaus-Peter Flosbach  
MdB Bartholomäus Kalb  
MdB Manfred Zöllmer  
MdB Dr Jens Zimmermann  
Mdb Dr Axel Troost

#### **Representing the private sector and the academic community**

Dr Christian Ossig  
Dr Jörg von Fürstenwerth  
Thomas Richter  
Prof. Isabel Schnabel  
Prof. Brigitte Haar  
Prof. Fred Wagner

As at: March 2018

### 2.2 Members of the Advisory Board

#### **Representing credit institutions**

Dr Christian Ossig  
Dr Karl-Peter Schackmann-Fallis  
Gerhard Hofmann  
Dr Oliver Wagner  
Jens Tolckmitt  
Iris Bethge

#### **Representing insurance undertakings**

Dr Wolfgang Weiler (Deputy Chair)  
Dr Jörg Freiherr Frank von Fürstenwerth  
Dr Markus Faulhaber  
Dr Immo Querner

#### **Representing asset management companies**

Rudolf Siebel

#### **Representing the Bundesbank**

Erich Loeper

#### **Representing the Association of Private Health Insurers**

Uwe Laue

#### **Representing the academic community**

Prof. Andreas Hackethal  
Prof. Andreas Richter  
Prof. Isabel Schnabel (Chair)

#### **Representing the Working Group on Occupational Retirement Provision**

- aba -  
Heribert Karch

#### **Representing consumer protection organisations**

Stephan Kühnlenz  
Prof. Günter Hirsch  
Dr h.c. Hans-Joachim Bauer

#### **Representing the liberal professions**

Frank Rottenbacher

#### **Representing associations for SMEs**

Ralf Frank

#### **Representing the trade unions**

Leonhard Regneri

#### **Representing industry**

Ralf Brunkow

As at: December 2017

## 2.3 Members of the Insurance Advisory Council

Dr Helmut Aden  
Dr Guido Bader  
Dr Karin Becker  
Dr Frank Ellenbürger  
Christian J. Fuchs  
Prof. Nadine Gatzert  
Prof. Helmut Gründl  
Martina Grundler  
Prof. Maria Heep-Altiner  
Jörg F. Henne  
Burkhard Keese  
Dr Mathias Kleuker  
Sandra Klug  
Uwe Laue  
Katharina Lawrence  
Dr Ursula Lipowsky  
Hubertus Münster  
Ute Pesch  
Prof. Petra Pohlmann  
Dr Markus Rieß  
Holger R. Rohde  
Prof. Heinrich R. Schradin  
Prof. Manfred Wandt  
Michael Wortberg

As at: October 2017

## 2.4 Members of the Securities Council

Baden-Württemberg Ministry for Finance and Economics  
Bavarian Ministry of Economic Affairs, Energy and Technology  
Berlin Senate Department for Economics, Energy and Public Enterprise  
The Ministry for Economic Affairs and Energy 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, Employment and Health of the State of Mecklenburg-Western Pomerania  
Ministry of Economic Affairs, Employment, Transport and Digitalisation of the State of Lower Saxony  
Ministry of Finance of the State of North Rhine-Westphalia  
Ministry for Economics, Transport, Agriculture and Viniculture of the State of Rhineland-Palatinate  
Ministry for Economic Affairs, Labour, Energy and Transport of the State of Saarland  
Ministry for Economic Affairs, Labour and Transport of the State of Saxony  
Ministry of Economy, Science and Digitalisation 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 2018

## 2.5 Members of the Consumer Advisory Council

### **Representing the academic community**

Prof. Brigitte Haar (Deputy Chair)

Prof. Kai-Oliver Knops

Prof. Udo Reifner

### **Representing consumer and investor protection organisations**

Jella Benner-Heinacher

Stephan Kühnlitz

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: December 2017

# 3 Authorised credit institutions, insurers and *Pensionsfonds*

## 3.1 Credit institutions supervised by BaFin or the ECB

### 3.1.1 Authorised institutions

In 2017 BaFin was responsible for supervising a total of 1,577 German credit institutions (previous year: 1,655) and 47 housing enterprises with savings schemes (previous year: 47, see Table 31).

Of the total of 1,579 credit institutions, 1,522 were CRR credit institutions (previous year: 1,596). Of these 1,522 CRR credit institutions, 1,457 (previous year: 1,528) were subject to direct supervision by BaFin as less significant institutions (LSIs) under the Single Supervisory Mechanism (SSM) (see info box "Credit institution or not?"). The 25 securities trading banks, 32 other credit institutions and 47 housing enterprises with savings schemes referred to in Table 32 (page 181) were supervised exclusively by BaFin.

**Table 31: German institutions**

	1,522
CRR credit institutions*	of which SIs** 63
	of which LSIs*** 1,457
Securities trading banks	25
Other credit institutions	32
<b>Total credit institutions</b>	<b>1,579</b>
<b>Housing enterprises with savings schemes</b>	<b>47</b>

\* Two of these CRR credit institutions are neither SIs nor LSIs.

\*\* The SIs are supervised directly by the ECB. This table lists the individual institutions. See chapter III 2.5.1. (SI groups).

\*\*\* Two of these credit institutions provide financial market infrastructures and are therefore supervised by BaFin's Securities Supervision Directorate.

### 3.1.2 German institutions directly supervised by the ECB under the SSM

63 of the German CRR credit institutions referred to in Table 31 (previous year: 66) were directly supervised by the European Central Bank (ECB) (see Table 32 on page 181) in 2017 as significant institutions (SIs) under the SSM. BaFin is involved in their supervision as part of the SSM.

#### Definition

### Credit institution or not?

A **credit institution** is an undertaking which conducts at least one of the types of 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. Banking business includes 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 32: German institutions supervised by the ECB under the SSM**

Aareal Bank AG	Landesbank Hessen-Thüringen Girozentrale
Bankhaus Neelmeyer Aktiengesellschaft	Landeskreditbank Baden-Württemberg - Förderbank -
Bausparkasse Schwäbisch Hall Aktiengesellschaft, Bausparkasse der Volksbanken und Raiffeisenbanken	Landwirtschaftliche Rentenbank
Bayerische Landesbank	Merck Finck Privatbankiers AG
Berlin Hyp AG	MKB Mittelrheinische Bank Gesellschaft mit beschränkter Haftung
Bethmann Bank AG	Münchener Hypothekenbank eG
BHW Bausparkasse Aktiengesellschaft	NATIXIS Pfandbriefbank AG
comdirect bank Aktiengesellschaft	Norddeutsche Landesbank -Girozentrale-
Commerz Finanz GmbH	norisbank GmbH
COMMERZBANK Aktiengesellschaft	NRW.BANK
CreditPlus Bank Aktiengesellschaft	PSA Bank Deutschland GmbH
DB Investment Services GmbH	S Broker AG & Co. KG
DekaBank Deutsche Girozentrale	Sal. Oppenheim jr. & Cie. AG & Co. Kommanditgesellschaft auf Aktien
DEUTSCHE APOTHEKER- UND ÄRZTEBANK EG	Santander Consumer Bank Aktiengesellschaft
DEUTSCHE BANK AKTIENGESELLSCHAFT	SEB AG
Deutsche Bank Bauspar-Aktiengesellschaft	Sparkasse Mittelholstein Aktiengesellschaft
Deutsche Bank Europe GmbH	State Street Bank International GmbH
Deutsche Bank Privat- und Geschäftskunden Aktiengesellschaft	TARGO Commercial Finance AG
Deutsche Genossenschafts-Hypothekenbank Aktiengesellschaft	TARGOBANK AG & Co. KGaA
Deutsche Hypothekenbank (Actien-Gesellschaft)	TeamBank AG Nürnberg
Deutsche Kreditbank Aktiengesellschaft	UniCredit Bank AG
Deutsche Pfandbriefbank AG	Volkswagen Bank Gesellschaft mit beschränkter Haftung
Deutsche Postbank AG	VON ESSEN Bank GmbH
Dexia Kommunalbank Deutschland AG	VR DISKONTBANK GmbH
DVB Bank SE	VTB Bank (Deutschland) Aktiengesellschaft
DZ BANK AG Deutsche Zentral-Genossenschaftsbank, Frankfurt am Main	WL BANK AG Westfälische Landschaft Bodenkreditbank
European Bank for Financial Services GmbH (ebase)	
FIDOR Bank AG	
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	

### 3.1.3 Calculation of the capital requirements

#### Use of IRB Approaches

As at the 31 December 2017 reporting date, a total of 12 less significant institutions and groups of institutions and one development bank were using internal ratings-based (IRB) approaches to calculate their capital requirements for credit risk. These institutions and groups of institutions and the development bank under supervision did not apply 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 4 of the 12 less significant institutions and groups of institutions and one development bank used the advanced IRB approach on a group or individual basis, and 3 institutions applied the IRB approach on an individual basis exclusively for the risk positions arising from their retail business.

#### Operational risk approaches

The German institutions or groups of institutions in Germany employ all four available approaches to calculate their capital requirements for operational risk. The basic indicator approach (BIA) and the standardised approach (STA) are determined using the specified indicator, which is based on the income statement figures. At the 2017 year-end, just over 1,500 institutions and groups of institutions – almost exclusively LSIs – were using the basic indicator approach. Another 54 institutions or groups of institutions, of which 26 are supervised by the ECB and 28 directly by BaFin, were applying the standardised approach. Two institutions or groups of institutions were working with the alternative standardised approach (ASA), which uses a standardised earnings indicator instead of the specified indicator. BaFin is responsible for these institutions.

The advanced measurement approach (AMA) does not make use of indicators, but uses 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 a group of institutions is calculated on the basis of this information with the help of a complex model. At the close of 2017, a total of 13 institutions and groups of institutions, of which 6 were German and 7 foreign institutions, were applying the AMA. Of the German institutions, four are supervised by the ECB and 2 by BaFin. Of the foreign institutions, 5 are supervised by the ECB and 2 by BaFin.

Following the publication of the new framework for determining operational risk by the Basel Committee in December 2017, it will probably no longer be possible to use a model-based approach for Pillar I purposes from 2022 onwards. However, BaFin expects that model-based approaches will continue to be important for determining economic capital, especially for significant institutions, beyond 2022. Moreover, the AMA will be the legal reality for at least another four years. For those reasons, BaFin once again insisted on necessary model improvements and modifications under the AMA in 2017.

As in previous years, BaFin focused on the procedures for measuring, controlling and monitoring legal risks and IT risks. IT risks in particular have grown in significance and will become increasingly significant over the next few years.

## 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 2017, while the number of *Pensionsfonds* rose slightly. At the end of the year under review, BaFin supervised a total of 552 insurance undertakings (previous year: 555) and 31 *Pensionsfonds* (previous year: 29). Of the total number of insurers, 528 were engaged in business activities and 24 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 10 public-law insurance undertakings supervised by the federal states. The breakdown of the undertakings by insurance class is therefore as follows (see Table 33 on page 183):

**Table 33: Number of supervised insurance undertakings and Pensionsfonds\***

As at 31 December 2017

	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
<i>Pensionskassen</i>	136	0	136	3	0	3
Funeral expenses funds	34	0	34	1	0	1
Health insurers	46	0	46	0	0	0
Property/casualty insurers**	200	7	207	6	0	6
Reinsurers	28	0	28	5	0	5
<b>Total</b>	<b>528</b>	<b>10</b>	<b>538</b>	<b>24</b>	<b>0</b>	<b>24</b>
<i>Pensionsfonds</i>	31	0	31	0	0	0

\* These figures do not include the smaller mutual insurance associations whose activities are mostly regionally based and which are supervised by the federal states (BaFin 2016 statistics – Primary insurers and Pensionsfonds, page 7, 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 details of the projection for health insurers in chapter IV 2.5.2.

**Life insurers**

2 life insurers supervised by BaFin ceased operating in 2017. 2 undertakings were granted new authorisations. 1 life insurer from the Netherlands established a branch office in Germany. 3 insurers from the European Economic Area (EEA) registered for the cross-border provision of services in Germany (see Table 34 "Registrations by EEA life insurers in 2017").

**Health insurers**

1 health insurance undertaking terminated its activities. 1 undertaking obtained a new authorisation.

**Property and casualty insurers**

3 property and casualty insurers supervised by BaFin ceased operating in 2017. 2 undertakings were granted new authorisations during the year under review. 5 property and casualty insurers from the EEA (Denmark, France, Ireland, Liechtenstein and Luxembourg) established a branch office in Germany. 1 branch office from each of the United Kingdom, the Netherlands and Sweden terminated its activities. 24 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 life insurers in 2017**

As at 31 December 2017

Country	CBS*	BO**
Belgium	1	
Malta	2	
Netherlands		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 35 "Registrations by EEA property and casualty insurers in 2017" on page 184).

**Reinsurers**

The number of active reinsurers under BaFin's supervision amounted to 28 in the year under review. Another 5 reinsurers are no longer accepting new business. 6 branches of undertakings from the EEA (Ireland, Luxembourg, Spain and three from France) were operating in Germany in 2017.

**Table 35: Registrations by EEA property and casualty insurers in 2017**

As at 31 December 2017

<b>Country</b>	<b>CBS*</b>	<b>BO**</b>
Bulgaria	1	
Denmark	1	1
Finland	1	
France	2	1
United Kingdom	2	
Ireland	3	1
Liechtenstein	1	1
Lithuania	1	
Luxembourg	3	1
Malta	4	
Poland	2	
Romania	1	
Sweden	1	
Spain	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***

2 *Pensionskassen* and 1 funeral expenses fund terminated their activities in 2017. 1 *Pensionskasse* terminated its activities with retrospective effect as of the 2016 reporting year. 2 *Pensionsfonds* received new authorisations in 2017.



## 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 2017 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 2017 is compared with the number of policies in the respective insurance class as at 31 December 2016. 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 2016 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	Number of life insurance contracts	Complaints
1001	AACHENMÜNCHENER LEB.	5,112,537	62
1006	ALLIANZ LEBEN	10,546,803	103
1007	ALTE LEIPZIGER LEBEN	1,391,428	49
1017	ATHENE LEBEN AG	286,914	12
1020	AXA LEBEN	2,838,199	55
1011	BARMENIA LEBEN	240,265	5
1028	BASLER LEBEN	676,856	18
1013	BAYER. BEAMTEN LEBEN	195,881	2
1015	BAYERN-VERS.	1,829,096	16
1122	CONCORDIA LEBEN	n. a.	1
1177	CONCORDIA OECO LEBEN	173,303	3
1021	CONDOR LEBEN	219,331	4
1335	CONTINENTALE LV AG	719,202	10
1022	COSMOS LEBEN	1,390,155	24
1115	CREDIT LIFE AG	909,948	1
1023	DEBEKA LEBEN	3,385,116	33
1136	DEVK ALLG. LEBEN	804,968	8
1025	DEVK DT. EISENBAHN LV	571,213	5
1113	DIALOG LEBEN	306,327	1
1180	DT. ÄRZTEVERSICHERUNG	217,426	2
1148	DT. LEBENSVERS.	650,985	3
1343	ENTIS LV AG	n. a.	4
1130	ERGO DIREKT LEBEN AG	1,019,398	24
1184	ERGO LEBEN AG	4,651,870	80
1151	ERGO VORSORGE LEBEN	164,670	2
1107	EUROPA LEBEN	485,717	5
1035	FRANKFURT MÜNCHENER	307,942	9
1152	FRANKFURTER LEBEN	n. a.	7
1139	GENERALI LEBEN AG	4,246,777	83
1108	GOTHAER LEBEN AG	1,323,091	34
1312	HANNOVERSCHE LV AG	964,088	5
1114	HANSEMERKUR LEBEN	292,031	2
1033	HDI LEBEN AG	2,215,765	57
1158	HEIDELBERGER LV	382,157	17
1137	HELVETIA LEBEN	148,590	2
1055	HUK-COBURG-LEBEN	670,592	22

Please refer to the "Explanatory notes on the statistics" on page 185.

1047	IDEAL LEBEN	594,793	6
1048	IDUNA VEREINIGTE LV	1,687,395	31
1119	INTERRISK LEBENSVERS.	91,339	1
1045	KARLSRUHER LV AG	85,806	2
1054	LANDESLEBENSHILFE	15,734	1
1062	LEBENSVERS. VON 1871	657,512	6
1112	LVM LEBEN	789,294	3
1109	MECKLENBURG. LEBEN	164,034	4
1064	MÜNCHEN. VEREIN LEBEN	n.a.	1
1342	MÜNCHENER VEREIN LEBEN	133,079	2
1164	NEUE LEBEN LEBENSVERS	900,616	10
1147	NÜRNBG. LEBEN	2,684,041	43
1056	OEFF. LEBEN BERLIN	224,807	3
1194	PB LEBENSVERSICHERUNG	1,095,658	33
1123	PLUS LEBEN	64,635	3
1309	PROTEKTOR LV AG	100,092	3
1081	PROV. LEBEN HANNOVER	815,692	8
1083	PROV.NORDWEST LEBEN	1,684,119	21
1082	PROV.RHEINLAND LEBEN	1,219,451	19
1085	R+V LEBEN	55,167	2
1141	R+V LEBENSVERS. AG	4,203,547	23
1018	RHEINLAND LEBEN	89,550	1
1150	SAARLAND LEBEN	145,063	1
1157	SKANDIA LEBEN	270,550	70
1153	SPARK.-VERS.SACHS.LEB	549,820	1
1104	STUTTGARTER LEBEN	503,100	6
1091	SV SPARKASSENVERS.	1,648,590	17
1090	SWISS LIFE AG (CH)	877,816	21
1132	TARGO LEBEN AG	1,869,308	11
1092	UNIVERSA LEBEN	178,639	4
1140	VICTORIA LEBEN	1,036,702	28
1099	VOLKSWOHL-BUND LEBEN	1,429,154	15
1160	VPV LEBEN	758,096	12
1149	WGV-LEBEN	56,274	2
1005	WÜRTT. LEBEN	2,126,106	34
1103	WWK LEBEN	916,303	27
1138	ZURICH DTSCH. HEROLD	3,245,451	67

Please refer to the "Explanatory notes on the statistics" on page 185.

### 4.3 Health insurance

Reg. no.	Name	Number of persons insured	Complaints
4034	ALLIANZ PRIV.KV AG	2,617,887	60
4142	ALTE OLDENBURGER AG	161,679	4
4112	ARAG KRANKEN	595,223	20
4095	AXA KRANKEN	1,733,457	210
4042	BARMENIA KRANKEN	1,230,199	36
4134	BAYERISCHE BEAMTEN K	1,132,075	28
4004	CENTRAL KRANKEN	1,721,082	62
4118	CONCORDIA KRANKEN	99,270	2
4001	CONTINENTALE KRANKEN	1,358,302	50
4028	DEBEKA KRANKEN	4,002,120	52
4131	DEVK KRANKENVERS.-AG	391,403	6
5129	DFV DEUTSCHE FAM.VERS	n. a.	3
4044	DKV AG	4,400,233	113
4013	DT. RING KRANKEN	593,748	12
4121	ENVIVAS KRANKEN	406,356	5
4126	ERGO DIREKT KRANKEN	1,510,964	12
4119	GOTHAER KV AG	591,553	17
4043	HALLESCHE KRANKEN	641,604	45
4144	HANSEMERKUR KRANKEN_V	1,473,189	24
4122	HANSEMERKUR S.KRANKEN	6,710,973	2
4117	HUK-COBURG KRANKEN	1,028,380	36
4031	INTER KRANKEN	n. a.	2
4145	INTER KV AG	376,713	10
4011	LANDESKRANKENHILFE	366,091	35
4109	LVM KRANKEN	351,864	5
4037	MÜNCHEN.VEREIN KV	314,585	17
5070	NEXIBLE VERS. AG	n. a.	1
4125	NÜRNBG. KRANKEN	280,917	1
4116	R+V KRANKEN	884,433	5
4002	SIGNAL IDUNA KRANKEN	1,977,989	42
4039	SÜDDEUTSCHE KRANKEN	666,892	14
4108	UNION KRANKENVERS.	1,206,407	9
4045	UNIVERSA KRANKEN	358,170	8

Please refer to the "Explanatory notes on the statistics" on page 185.

## 4.4 Motor vehicle insurance

Reg. no.	Name	Number of insured risks	Complaints
5342	AACHENMÜNCHENER VERS.	2,428,610	18
5135	ADAC AUTOVERSICHERUNG	1,099,280	17
5312	ALLIANZ VERS.	12,406,295	82
5441	ALLSECUR DEUTSCHLAND	1,238,264	54
5405	ALTE LEIPZIGER VERS.	419,640	4
5397	ASSTEL SACH	n. a.	3
5155	AXA EASY	195,181	13
5515	AXA VERS.	4,955,289	49
5317	BARMENIA ALLG. VERS.	302,535	2
5633	BASLER SACH AG	311,602	2
5310	BAYER. BEAMTEN VERS.	198,093	2
5324	BAYER.VERS.VERB.AG	1,822,658	6
5146	BGV-VERSICHERUNG AG	722,145	1
5098	BRUDERHILFE SACH.AG	430,242	2
5338	CONCORDIA VERS.	978,878	3
5339	CONDOR ALLG. VERS.	245,636	4
5340	CONTINENTALE SACHVERS	735,488	6
5552	COSMOS VERS.	990,944	14
5343	DA DEUTSCHE ALLG.VER.	1,181,911	34
5513	DEVK ALLG. VERS.	4,014,353	25
5344	DEVK DT. EISENB. SACH	1,006,114	1
5562	ERGO DIREKT	n. a.	2
5472	ERGO VERSICHERUNG	2,314,799	25
5508	EUROPA VERSICHERUNG	695,343	17
5470	FAHRLEHRERVERS.	324,041	2
5024	FEUERSOZIJETÄT	147,349	1
5505	GARANTA VERS.	545,204	4
5473	GENERALI VERSICHERUNG	2,226,143	18
5858	GOTHAER ALLGEMEINE AG	1,448,119	8
5585	GVV-PRIVATVERSICH.	203,539	1
5501	HANSEMERKUR ALLG.	n. a.	2
5096	HDI GLOBAL SE	894,215	14
5085	HDI VERSICHERUNG	2,656,817	41
5044	HDNA VVAG	n. a.	1
5448	HELVETIA	n. a.	2
5384	HELVETIA VERS. (CH)	314,760	7

Please refer to the "Explanatory notes on the statistics" on page 185.

5086	HUK24 AG	3,539,322	45
5375	HUK-COBURG UNTER.	7,237,505	52
5521	HUK-COBURG-ALLG. VERS	8,832,444	75
5401	ITZEHOER VERSICHERUNG	1,433,924	23
5078	JANITOS VERSICHERUNG	122,019	2
5058	KRAVAG-ALLGEMEINE	1,632,353	13
5080	KRAVAG-LOGISTIC	1,088,588	21
5402	LVM SACH	5,820,388	28
5061	MANNHEIMER VERS.	221,105	1
5412	MECKLENBURG. VERS.	865,882	5
5426	NÜRNBG. ALLG.	230,487	2
5787	OVAG - OSTDT. VERS.	358,928	9
5446	PROV.NORD BRANDKASSE	786,641	4
5095	PROV.RHEINLAND VERS.	1,458,668	9
5438	R+V ALLGEMEINE VERS.	4,146,682	28
5137	R+V DIREKTVERSICHER.	468,151	14
5051	S DIREKTVERSICHERUNG	314,656	5
5773	SAARLAND FEUERVERS.	168,277	1
5125	SIGNAL IDUNA ALLG.	1,053,929	10
5781	SPARK.-VERS.SACHS.ALL	187,179	1
5036	SV SPARK.VERSICHER.	1,018,406	1
5767	THÜGA SCHADENAUSGL.	n. a.	3
5042	VERSICHERUNGSK.BAYERN	166,456	1
5055	VERTI VERSICHERUNG	1,252,787	45
5400	VGH LAND.BRAND.HAN.	1,961,170	10
5862	VHV ALLGEMEINE VERS.	4,836,208	62
5169	VOLKSWAGEN AUTO AG	772,085	18
5093	WESTF.PROV.VERS.AG	1,453,441	13
5525	WGV-VERSICHERUNG	1,335,587	11
5479	WÜRTT. GEMEINDE-VERS.	1,038,176	3
5783	WÜRTT. VERS.	2,882,405	23

Please refer to the "Explanatory notes on the statistics" on page 185.

## 4.5 General liability insurance

Reg. no.	Name	Number of insured risks	Complaints
5342	AACHENMÜNCHENER VERS.	1,300,057	7
5035	AGILA HAUSTIER AG	n. a.	1
5312	ALLIANZ VERS.	4,330,539	34
5405	ALTE LEIPZIGER VERS.	197,952	2
5068	AMMERLÄNDER VERS.	n. a.	1
5455	ARAG ALLG. VERS.	21,123,262	5
5397	ASSTEL SACH	n. a.	6
5515	AXA VERS.	3,198,733	18
5317	BARMENIA ALLG. VERS.	237,057	2
5633	BASLER SACH AG	336,093	3
5324	BAYER.VERS.VERB.AG	1,126,594	9
5098	BRUDERHILFE SACH.AG	213,948	1
5338	CONCORDIA VERS.	361,890	1
5340	CONTINENTALE SACHVERS	441,092	1
5552	COSMOS VERS.	322,729	1
5343	DA DEUTSCHE ALLG.VER.	n. a.	2
5549	DEBEKA ALLGEMEINE	1,369,572	5
5513	DEVK ALLG. VERS.	1,218,893	1
5472	ERGO VERSICHERUNG	1,581,740	25
5508	EUROPA VERSICHERUNG	n. a.	6
5024	FEUERSOZietät	166,710	1
5366	GEMEINN. HAFT	n. a.	1
5473	GENERALI VERSICHERUNG	1,545,911	12
5858	GOTHAER ALLGEMEINE AG	1,418,634	17
5469	GVV-KOMMUNALVERS.	3,465	5
5374	HAFTPFLICHTKASSE	402,263	9
5501	HANSEMERKUR ALLG.	279,848	4
5096	HDI GLOBAL SE	15,125	4
5085	HDI VERSICHERUNG	1,362,785	24
5384	HELVETIA VERS. (CH)	359,093	4
5086	HUK24 AG	444,926	3
5375	HUK-COBURG UNTER.	2,017,452	4
5521	HUK-COBURG-ALLG. VERS	1,591,016	4
5573	IDEAL VERS.	n. a.	1
5546	INTER ALLG. VERS.	117,065	4
5780	INTERRISK VERS.	n. a.	1

Please refer to the "Explanatory notes on the statistics" on page 185.

5401	ITZEHOER VERSICHERUNG	169,010	1
5078	JANITOS VERSICHERUNG	197,125	5
5080	KRAVAG-LOGISTIC	n. a.	1
5402	LVM SACH	1,359,290	7
5061	MANNHEIMER VERS.	154,160	4
5412	MECKLENBURG. VERS.	280,707	2
5426	NÜRNBG. ALLG.	319,865	2
5017	OSTANGLER BRANDGILDE	n. a.	1
5787	OVAG - OSTDT. VERS.	n. a.	4
5446	PROV.NORD BRANDKASSE	371,716	2
5095	PROV.RHEINLAND VERS.	843,383	6
5583	PVAG POLIZEIVERS.	n. a.	1
5438	R+V ALLGEMEINE VERS.	1,859,900	17
5121	RHION VERSICHERUNG	179,050	2
5773	SAARLAND FEUERVERS.	88,162	2
5125	SIGNAL IDUNA ALLG.	703,996	7
5036	SV SPARK.VERSICHER.	1,059,813	3
5459	UELZENER ALLG. VERS.	n. a.	1
5042	VERSICHERUNGSK.BAYERN	15,678	6
5055	VERTI VERSICHERUNG	n. a.	1
5400	VGH LAND.BRAND.HAN.	783,349	7
5862	VHV ALLGEMEINE VERS.	1,445,930	15
5461	VPV ALLGEMEINE VERS.	n. a.	1
5093	WESTF.PROV.VERS.AG	832,582	4
5525	WGV-VERSICHERUNG	353,236	3
5479	WÜRTT. GEMEINDE-VERS.	273,454	3
5783	WÜRTT. VERS.	1,180,260	6
5476	WWK ALLGEMEINE VERS.	143,126	1

Please refer to the "Explanatory notes on the statistics" on page 185.



## 4.6 Accident insurance

Reg. no.	Name	Number of insured risks	Complaints
5342	AACHENMÜNCHENER VERS.	2,519,949	9
5498	ADAC - SCHUTZBRIEF VERS.	3,512,859	7
5312	ALLIANZ VERS.	3,923,047	30
5405	ALTE LEIPZIGER VERS.	62,799	1
5068	AMMERLÄNDER VERS.	n. a.	1
5455	ARAG ALLG. VERS.	20,955,489	1
5515	AXA VERS.	864,218	6
5792	BADEN-BADENER VERS.	275,059	3
5317	BARMENIA ALLG. VERS.	177,611	1
5633	BASLER SACH AG	389,504	3
5310	BAYER. BEAMTEN VERS.	102,422	4
5324	BAYER.VERS.VERB.AG	981,417	2
5338	CONCORDIA VERS.	356,121	1
5340	CONTINENTALE SACHVERS	591,165	2
5552	COSMOS VERS.	173,352	2
5549	DEBEKA ALLGEMEINE	1,941,860	2
5129	DFV DEUTSCHE FAM.VERS	n. a.	1
5562	ERGO DIREKT	233,210	3
5472	ERGO VERSICHERUNG	1,994,562	17
5473	GENERALI VERSICHERUNG	2,450,933	9
5858	GOTHAER ALLGEMEINE AG	677,046	6
5365	GVO GEGENSEITIGKEIT	n. a.	1
5501	HANSEMERKUR ALLG.	91,448	1
5085	HDI VERSICHERUNG	474,626	4
5384	HELVETIA VERS. (CH)	120,482	1
5375	HUK-COBURG UNTER.	979,460	4
5521	HUK-COBURG-ALLG. VERS	746,008	1
5780	INTERRISK VERS.	482,195	2
5078	JANITOS VERSICHERUNG	168,571	4
5058	KRAVAG-ALLGEMEINE	n. a.	1
5061	MANNHEIMER VERS.	59,156	1
5426	NÜRNBG. ALLG.	488,780	8
5095	PROV.RHEINLAND VERS.	2,399,458	1
5583	PVAG POLIZEIVERS.	318,491	1
5438	R+V ALLGEMEINE VERS.	1,411,961	4
5121	RHION VERSICHERUNG	130,037	1

Please refer to the "Explanatory notes on the statistics" on page 185.

5125	SIGNAL IDUNA ALLG.	1,685,231	11
5586	STUTTGARTER VERS.	558,075	9
5036	SV SPARK.VERSICHER.	280,916	4
5400	VGH LAND.BRAND.HAN.	5,087,924	1
5862	VHV ALLGEMEINE VERS.	424,783	2
5093	WESTF.PROV.VERS.AG	838,504	1
5479	WÜRTT. GEMEINDE-VERS.	145,820	1
5783	WÜRTT. VERS.	708,373	1
5590	WÜRZBURGER VERSICHER.	n. a.	2
5476	WWK ALLGEMEINE VERS.	278,941	3

Please refer to the "Explanatory notes on the statistics" on page 185.

## 4.7 Household contents insurance

Reg. no.	Name	Number of insured risks	Complaints
5342	AACHENMÜNCHENER VERS.	951,788	3
5312	ALLIANZ VERS.	2,501,959	18
5405	ALTE LEIPZIGER VERS.	114,082	1
5068	AMMERLÄNDER VERS.	360,000	6
5455	ARAG ALLG. VERS.	864,688	3
5397	ASSTEL SACH	n. a.	1
5515	AXA VERS.	1,270,743	15
5317	BARMENIA ALLG. VERS.	n. a.	1
5633	BASLER SACH AG	252,556	1
5146	BGV-VERSICHERUNG AG	n. a.	2
5098	BRUDERHILFE SACH.AG	178,793	2
5339	CONDOR ALLG. VERS.	n. a.	1
5340	CONTINENTALE SACHVERS	213,775	1
5343	DA DEUTSCHE ALLG.VER.	n. a.	3
5513	DEVK ALLG. VERS.	929,265	3
5344	DEVK DT. EISENB. SACH	419,112	1
5328	DOCURA VVAG	n. a.	1
5562	ERGO DIREKT	n. a.	2
5472	ERGO VERSICHERUNG	1,010,038	18
5508	EUROPA VERSICHERUNG	n. a.	1
5024	FEUERSOZIJETÄT	115,800	1
5473	GENERALI VERSICHERUNG	1,189,131	8
5858	GOTHAER ALLGEMEINE AG	700,889	7
5365	GVO GEGENSEITIGKEIT	n. a.	2
5374	HAFTPFLICHTKASSE	257,008	2
5012	HAMB. LEHRER-FEUEK.	n. a.	1
5501	HANSEMERKUR ALLG.	n. a.	1
5085	HDI VERSICHERUNG	701,170	6
5384	HELVETIA VERS. (CH)	236,910	1
5086	HUK24 AG	250,676	1
5375	HUK-COBURG UNTER.	1,439,278	8
5521	HUK-COBURG-ALLG. VERS	937,473	6
5573	IDEAL VERS.	n. a.	1
5546	INTER ALLG. VERS.	n. a.	1
5401	ITZEHOER VERSICHERUNG	87,987	1
5078	JANITOS VERSICHERUNG	111,982	1
5404	LBN	111,479	2

Please refer to the "Explanatory notes on the statistics" on page 185.

5402	LVM SACH	823,673	1
5061	MANNHEIMER VERS.	60,173	2
5426	NÜRNBG. ALLG.	156,097	1
5446	PROV.NORD BRANDKASSE	264,578	1
5095	PROV.RHEINLAND VERS.	501,955	2
5583	PVAG POLIZEIVERS.	n. a.	1
5438	R+V ALLGEMEINE VERS.	1,074,961	7
5798	RHEINLAND VERS. AG	n. a.	1
5121	RHION VERSICHERUNG	n. a.	1
5491	SCHLESWIGER VERS.V.	n. a.	1
5125	SIGNAL IDUNA ALLG.	320,939	3
5036	SV SPARK.VERSICHER.	518,289	1
5862	VHV ALLGEMEINE VERS.	399,557	1
5093	WESTF.PROV.VERS.AG	560,071	3
5525	WGV-VERSICHERUNG	155,970	2
5479	WÜRTT. GEMEINDE-VERS.	187,333	1
5783	WÜRTT. VERS.	734,716	3
5476	WWK ALLGEMEINE VERS.	n. a.	1

Please refer to the "Explanatory notes on the statistics" on page 185.

## 4.8 Residential building insurance

Reg. no.	Name	Number of insured risks	Complaints
5342	AACHENMÜNCHENER VERS.	402,881	6
5312	ALLIANZ VERS.	2,483,134	38
5405	ALTE LEIPZIGER VERS.	117,596	5
5455	ARAG ALLG. VERS.	146,811	4
5515	AXA VERS.	854,118	17
5317	BARMENIA ALLG. VERS.	46,937	2
5633	BASLER SACH AG	181,369	3
5310	BAYER. BEAMTEN VERS.	n. a.	1
5319	BAYER. HAUSBESITZER	31,578	1
5043	BAYER.L-BRAND.VERS.AG	2,049,326	7
5324	BAYER.VERS.VERB.AG	870,066	8
5339	CONDOR ALLG. VERS.	140,936	5
5340	CONTINENTALE SACHVERS	133,337	1
5552	COSMOS VERS.	n. a.	1
5549	DEBEKA ALLGEMEINE	263,913	2
5513	DEVK ALLG. VERS.	398,555	1
5344	DEVK DT. EISENB. SACH	182,247	2
5522	DOLLERUP.FREIE BRANDG	n. a.	1
5472	ERGO VERSICHERUNG	411,133	11
5541	EUROP ASSISTANCE	n. a.	1
5024	FEUERSOZIJETÄT	83,526	1
5473	GENERALI VERSICHERUNG	540,661	10
5858	GOTHAER ALLGEMEINE AG	328,628	9
5485	GRUNDEIGENTÜMER-VERS.	81,741	2
5365	GVO GEGENSEITIGKEIT	n. a.	1
5032	HAMB. FEUERKASSE	161,488	1
5085	HDI VERSICHERUNG	271,361	5
5448	HELVETIA	n. a.	2
5384	HELVETIA VERS. (CH)	152,204	5
5126	HÜBENER VERSICHERUNG	n. a.	1
5086	HUK24 AG	88,248	3
5375	HUK-COBURG UNTER.	677,933	7
5521	HUK-COBURG-ALLG. VERS	282,250	3
5546	INTER ALLG. VERS.	n. a.	1
5057	INTERLLOYD VERS.AG	54,024	1
5780	INTERRISK VERS.	110,239	2

Please refer to the "Explanatory notes on the statistics" on page 185.

5404	LBN	n. a.	1
5402	LVM SACH	634,303	11
5061	MANNHEIMER VERS.	50,999	9
5412	MECKLENBURG. VERS.	108,263	1
5334	MEDIENVERS. KARLSRUHE	n. a.	3
5426	NÜRNBG. ALLG.	71,094	1
5446	PROV.NORD BRANDKASSE	300,292	4
5095	PROV.RHEINLAND VERS.	551,122	7
5438	R+V ALLGEMEINE VERS.	1,017,925	26
5798	RHEINLAND VERS. AG	n. a.	1
5125	SIGNAL IDUNA ALLG.	195,366	10
5781	SPARK.-VERS.SACHS.ALL	39,357	1
5036	SV SPARK.VERSICHER.	1,691,638	25
5042	VERSICHERUNGSK.BAYERN	n. a.	2
5400	VGH LAND.BRAND.HAN.	470,149	11
5862	VHV ALLGEMEINE VERS.	133,889	2
5461	VPV ALLGEMEINE VERS.	67,372	1
5093	WESTF.PROV.VERS.AG	585,705	7
5525	WGV-VERSICHERUNG	83,455	3
5479	WÜRTT. GEMEINDE-VERS.	87,440	1
5783	WÜRTT. VERS.	448,458	9
5476	WWK ALLGEMEINE VERS.	36,113	2

Please refer to the "Explanatory notes on the statistics" on page 185.

## 4.9 Legal expenses insurance

Reg. no.	Name	Number of insured risks	Complaints
5826	ADAC-RECHTSSCHUTZ	2,223,536	9
5809	ADVOCARD RS	1,523,449	34
5312	ALLIANZ VERS.	2,421,395	37
5405	ALTE LEIPZIGER VERS.	333,977	24
5455	ARAG ALLG. VERS.	n. a.	1
5800	ARAG SE	1,446,227	91
5801	AUXILIA RS	543,511	8
5838	BADISCHE RECHTSSCHUTZ	169,531	3
5310	BAYER. BEAMTEN VERS.	n. a.	2
5098	BRUDERHILFE SACH.AG	90,558	3
5338	CONCORDIA VERS.	421,488	7
5340	CONTINENTALE SACHVERS	126,329	4
5343	DA DEUTSCHE ALLG.VER.	n. a.	1
5549	DEBEKA ALLGEMEINE	426,865	7
5803	DEURAG DT. RS	1,218,523	48
5829	DEVK RECHTSSCHUTZ	1,107,762	31
5834	DMB RECHTSSCHUTZ	800,305	5
5472	ERGO VERSICHERUNG	2,098,404	33
5365	GVO GEGENSEITIGKEIT	n. a.	4
5096	HDI GLOBAL SE	5,864	1
5086	HUK24 AG	119,749	4
5818	HUK-COBURG RS	1,715,189	15
5573	IDEAL VERS.	n. a.	1
5401	ITZEHOER VERSICHERUNG	n. a.	1
5078	JANITOS VERSICHERUNG	n. a.	1
5402	LVM SACH	786,123	8
5412	MECKLENBURG. VERS.	145,673	3
5805	NEUE RECHTSSCHUTZ	450,660	16
5426	NÜRNBG. ALLG.	n. a.	1
5813	OERAG RECHTSSCHUTZ	1,798,370	39
5438	R+V ALLGEMEINE VERS.	778,360	12
5807	ROLAND RECHTSSCHUTZ	1,723,026	47
5400	VGH LAND.BRAND.HAN.	208,498	3
5525	WGV-VERSICHERUNG	427,632	16
5479	WÜRTT. GEMEINDE-VERS.	n. a.	1
5783	WÜRTT. VERS.	689,752	10

Please refer to the "Explanatory notes on the statistics" on page 185.

## 4.10 Insurers based in the EEA

Reg. no.	Name	Complaints	Reg. no.	Name	Complaints
7985	ADVIGON VERS. (LI)	15	7956	INTER PARTNER (B)	4
7685	AIG EUROPE (GB)	1	7587	INTERN.INSU.COR.(NL)	1
5163	AIG EUROPE LIMITED (GB)	8	7828	LA MONDIALE (LU)	1
5029	AIOI NISSAY (GB)	2	7031	LEGAL/GENERAL ASS(GB)	2
7778	ALPHA INS. A/S (DK)	2	9031	LIBERTY EURO.(IRL/E)	6
7509	AMTRUST INT. (IE)	4	9139	LIECHTENSTEIN L. (FL)	3
7923	ARCH INSUR. COMP.(GB)	1	7899	LIGHTHOUSE LIFE (GBZ)	1
7366	ARISA ASSURANCES (LU)	1	5592	LLOYD'S VERS. (GB)	1
5119	ASSURANT ALLG. (GB)	4	7199	LOMBARD INTERNAT. (L)	1
7053	AVIVA INSURANCE (GB)	1	5054	LONDON GENERAL I.(GB)	1
9357	AWP HEALTH (FR)	1	5130	MAPFRE ASISTENC.(E)	6
5636	AWP INTERNATION. (F)	31	5167	MARKEL INTERNATIONAL (GB)	1
7595	AXA FRANCE IARD (F)	1	9313	METLIFE EUROPE (IE)	1
9374	AXA LIFE EUROPE (IE)	6	1323	MONUTA VERS. (NL)	3
5145	BALCIA INS. (LV)	1	1340	NOVIS (SK)	1
7811	CACI LIFE DAC (IE)	2	5140	OBERÖSTERREICH. V.(A)	3
7786	CANADA LIFE (IE)	6	7723	PRISMALIFE AG (FL)	6
1300	CANADA LIFE (IRL)	8	7455	PROBUS INSURANCE (IE)	1
1182	CARDIF LEBEN (F)	14	7894	QUANTUM LEBEN AG(FL)	2
5056	CARDIF VERS. (F)	7	1317	R+V LUXEMB. LV (L)	1
5902	CHUBB EUROPEAN (GB)	16	7415	R+V LUXEMBOURG L (L)	3
9306	CNP SANT. (IE)	5	9158	RCI INSURANCE (MT)	1
9307	CNP SANTANDER (IE)	9	7453	SCOTT. WID. (GB)	12
7715	CREDIT SUISSE (FL)	1	5174	SOCIETATEA (RO)	2
5048	DOMESTIC AND GEN.(GB)	6	5128	SOGECAP DNL (F)	1
7483	ERGO LIFE (LU)	7	5177	SOGESSUR (F)	2
5175	EULER HERMES (B)	5	9012	SQUARELIFE (LI)	1
5115	EUROMAF SA (F)	2	1320	STANDARD LIFE (GB)	11
7231	EUROP ASSISTANCE (FR)	3	7763	STONEBRIDGE (GB)	2
7674	EUROPÄISCH.REISE. (A)	1	1328	SWISS LIFE PROD.(L)	1
5053	FINANCIAL INSUR.(GB)	1	5157	TELEFONICA INSURANCE (L)	59
9283	FRIENDS LIFE LIM. (GB)	4	5752	TOKIO MARINE EUR.(GB)	1
7203	FWU LIFE (LU)	4	7540	VALORLIFE LEBENS.(LI)	1
9016	GABLE INSURANCE (LI)	2	1311	VDV LEBEN INT. (GR)	2
9390	GEFION INS. (DK)	1	7456	VDV Leben International	2
7268	GENERALI VERS.AG (A)	3	7643	VIENNA-LIFE (FL)	1
7214	HELVETIA VERS. (A)	1	5152	W.R. BERKLEY (GB)	1
5079	HISCOX INS. (GB)	1	5182	W.R.BERKLEY (LI)	1
7688	INORA LIFE (IE)	4	5151	ZURICH INSURANCE (IRL)	52

Please refer to the "Explanatory notes on the statistics" on page 185.





**Insurance Supervision**

Guernsey	2011
Hong Kong	2008
Jersey	2012
California (USA)	2007
Canada	2004
Qatar	2008
Korea	2010
Croatia	2008
Latvia	2002
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
Vatican	2014

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