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### Federal Financial Supervisory Authority Annual Report 2008

Federal Republic of Germany: Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin)/Federal  
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BaFin



'08

**Annual Report**

**Federal Financial Supervisory Authority**

**(Bundesanstalt für Finanzdienstleistungsaufsicht – BaFin)**

A blurred photograph of a financial table or spreadsheet. The table contains several columns of data, including numbers and percentages. The text is out of focus but appears to be a standard financial report format.

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## President's Statement



BaFin's image is primarily defined by its logo, a mixed figurative and word mark which – we hope – benefits from a high level of recognition. We could have complemented it with a catchy slogan but have so far lacked the time to look for the right kind of words that might provide a succinct and appropriate description highlighting the essence of the German financial supervisory authority.

The current state of affairs, however, might force our hand in terms of imposing on us a watchword which, while sounding rather light-hearted, nevertheless carries a serious meaning for us:

"Things remain exciting!" Three words which not only describe BaFin's situation but also that of the international financial system over recent months: Things kept coming to a head which simply could not have been foreseen by anyone. To date, the fall of the house of Lehman in September 2008, which nearly triggered a global catastrophe, represented the nadir. At the last minute, the governments of the world's major industrialised nations avoided disaster by preventing the collapse of other financial institutions crucial to the system. Consequently, in Germany the Hypo Real Estate Group was rescued.

Since Lehman, the financial markets have been gripped by a deep sense of mistrust which has yet to be dispelled. The crisis has become some kind of normality. Things will indeed remain exciting, given that nobody can know whether a new storm is brewing somewhere. The financial crisis has triggered a deep global recession which in turn may have repercussions for financial markets. One alarming scenario would be if banks still burdened with toxic assets were forced to carry out major value adjustments which could worsen the crisis again.

These toxic assets must therefore be removed from the international financial system. Irrespective of the technique used to safeguard the banks against another loss of value regarding their toxic assets, the main point is that it must be adopted soon so as not to jeopardise the supply of credit to the economy. A national economy can quickly run into trouble if its banking industry is unable to operate. However, the big easy is going to cost the taxpayer money. But this money represents a sound investment given that it will serve to strengthen key institutions. This is our only chance to overcome the recession more rapidly than is currently forecast. It would be nice if we could gradually return to a state of affairs deserving of the description "normality".

A long time ago, the Nobel Prize Winner for Literature, Samuel Beckett, remarked that we live in such exciting times that the only thing left capable of actually shocking people is boredom. Such words could only come from somebody who did not have to live through the financial crisis. I believe that at present the world would like nothing better than a bit of boredom. For the time being, however, this is unfortunately no more than a pious hope.

Bonn and Frankfurt am Main | April 2009

A handwritten signature in black ink, reading "Jochen Sanio". The signature is written in a cursive, flowing style with some loops and flourishes.

Jochen Sanio  
President

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# I Introduction



The global financial crisis – and, above all, its dramatic intensification in September – forced the hand of the German financial supervisors and supervisory bodies around the world during the year under review. In April 2008, the Financial Stability Forum (FSF) – now the Financial Stability Board (FSB) – submitted its so-called Draghi Report to the G7 meeting. Named after the FSF Chairman Mario Draghi, the Report on Enhancing Market and Institutional Resilience comprised analyses and proposals from a number of financial market organisations as well as the Basel Committee on Banking Supervision, the International Organization of Securities Commissions (IOSCO), the Joint Forum of the International Accounting Standards Board (IASB) and the International Monetary Fund (IMF).

Whereas the financial crisis appeared to be confined to a relatively small segment of the US mortgage market in 2007, in 2008 it spread to other markets, worsening sharply in the process. Hedge funds, emerging markets and more and more areas of the manufacturing industry found themselves caught up in the turmoil, while at the same time the losses recorded in the international financial sector took on extraordinary dimensions, leading to a rapid erosion of the capital base. The dramatic and virtually synchronous collapse in economic activity around the world weakened the financial position of companies and private households. A further strain on financial institutions, already embattled in the wake of the financial crisis, was the deterioration in credit quality.

● Collapse of Lehman Brothers.

The crisis in confidence among financial institutions deepened in September when the US investment bank Lehman Brothers floundered and was not bailed out. The threatened collapse of the global financial system took centre stage for governments and central banks. In many countries, extensive rescue and recovery plans were launched and the EU Commission relaxed accounting rules in light of the financial crisis. At the global finance summit in November, the leading industrialised nations and biggest emerging markets decided on an action plan incorporating five basic principles for global financial reform. The primary aim of the plan is to close loopholes in regulation and supervision so that relevant market participants, markets or products will no longer go unsupervised in future.

● German rescue package for the financial sector.

As early as the start of October, the Federal Government put in place a state guarantee for private current account, savings account and term deposits. Shortly thereafter, it passed the Financial Market Stabilization Act and set up the Special Fund Financial Market Stabilization (SoFFin), in order to improve

coordination of the help measures and to come to grips with the growing number of liquidity and solvency problems among individual institutions based on a systemic approach. The Fund can grant government guarantees for bank liabilities. The aim of this measure is to revive the depressed interbank market. In addition, financial resources are available to take on risks and carry out recapitalisations, which are subject to stringent conditions. After a slow start, a number of institutions made use of the services provided by the Fund.

● Further loss of confidence in the financial sector.

Despite central banks injecting massive amounts of liquidity, the interbank market only operated to a very limited extent and threatened to dry up completely as confidence between banks dwindled further. Losses piled up and the banking landscape changed radically. In the USA, the era of pure investment banks came to an end. The US government and Federal Reserve took drastic measures to prevent the financial system from collapsing. In Europe too, many stricken credit institutions sought refuge in the arms of stronger competitors or were protected from collapse thanks to government investment.

● BaFin responds to the crisis.

The financial markets reacted very nervously to the failure of Lehman. The extreme uncertainty favoured speculative market manipulation. In the same way as some other financial supervisory authorities, BaFin therefore imposed a temporary ban on the uncovered short-selling of eleven German financial stocks. Persistent market upheaval has seen this ban on short-selling extended on two occasions, most recently until the end of May 2009. Findings from the financial crisis were also included in the circular entitled "Minimum requirements for the risk management of insurance companies (MaRisk VA)", which BaFin published in January 2009 following a great deal of preliminary work. For instance, in the MaRisk VA supervisors comment on incentives in the payments system or the separation of duties which are relatively incompatible.

## II Economic environment

### 1 From a financial to an economic crisis

Financial crisis spreads further.



The financial crisis triggered a year earlier by the US real estate market gradually extended to other markets and regions in 2008. From the purely monetary sphere of the financial sector, the turbulence increasingly spread to areas of the real economy as the year progressed. Towards the end of the year, the global economy was facing its deepest recession since the Second World War. The global economic slump weakened the financial position of companies and private households. A further strain on financial institutions already troubled as a result of the financial crisis is the deterioration in credit quality. However, the main impact on the balance sheets of financial institutions due to the slump will not become apparent until the credit cycle has touched bottom. If comparable economic periods are anything to go by, this process is likely to drag on for some time before any improvement can occur.

Origins in the US sub-prime mortgage market.

The origins of the financial crisis can be traced back to the relatively small segment of the US mortgage market relating to sub-prime borrowers. Excessive lending and harmful incentive mechanisms in the securitisation business were determining factors in creating a price bubble on the US housing market which was unsustainable over the long term.<sup>1</sup> When the bubble burst, low-income private households were the first to experience financial difficulties. The number of loan defaults in the sub-prime segment mounted up. The crisis soon spread to the global credit and financial markets as many US mortgages had been packaged into structured securities and sold to investors worldwide. With major uncertainty surrounding the value of this paper, a severe crisis of confidence broke out in the financial sector, which deepened further in 2008 as more and more financial institutions had to make sizeable write-downs running into billions in their quarterly results. The movement of liquid funds on the interbank market ground to a halt and failed to get going again in 2008 despite intensive efforts on the part of central banks.

Negative shocks trigger an international wave of consolidation.

In addition to continued large losses in the financial sector, a number of terrible news stories only served to depress sentiment further. In March, the collapse of the US investment bank Bear Stearns together with its hurriedly arranged emergency sale to JP Morgan caused a stir. However, the failure of Lehman Brothers in

<sup>1</sup> Annual Report of BaFin 2007, pp. 15-24 on the causes of the US sub-prime crisis.

September marked a particularly decisive turning point. On this occasion, the US government decided against a rescue package and instead allowed the bank to fail. This response sent shockwaves through the paralysed financial markets as the investment bank was widely considered to be too big to be abandoned. It was now clear that bankruptcies among larger banks could in future no longer be ruled out on principle. As a result, financial institutions kept an even closer watch on the credit rating of their business partners and built up surplus liquidity instead of making it available to the interbank market. Some specialist banks which do not have their own deposit-taking operations and have to rely on refinancing via the capital markets faced intractable problems. In the United States, Merrill Lynch sought refuge in the arms of Bank of America. The two remaining major investment banks, Goldman Sachs and Morgan Stanley, converted themselves into ordinary commercial banks so as to take advantage of the Federal Reserve's credit facilities. The era of the US investment banks had come to an abrupt end.

● Large-scale government intervention.

The changes in the banking landscape in the United States were especially far-reaching. Besides the disappearance of the pure investment banks, the changes affected above all those institutions with a large mortgage business. Many credit institutions were taken over by more broadly based – and thus less vulnerable – competitors. In some cases, however, government intervention was also required, and on a scale which until very recently had been quite unthinkable. For example, what was once the world's largest insurance group, AIG, had to be rescued with an emergency loan from the US Federal Reserve to the tune of \$85 billion. In return, the Federal Reserve was granted access to large parts of the insurer's assets. Fannie Mae and Freddie Mac, the two mortgage giants which in mid-2008 together either held or guaranteed 43% of all outstanding US mortgages, totalling \$12.1 trillion, had to be placed under government administration on account of the erosion of their assets. Finally, a \$700 billion rescue package for the US financial industry was rushed through in the autumn.

However, in Europe too, the financial system was subject to some considerable shifts. Several mortgage financiers and banking groups were either acquired by rivals or broken up and nationalised. In Germany, specialised institutions with capital market-based refinancing came under very intense pressure. For instance, the already beleaguered Hypo Real Estate found itself caught in a huge liquidity squeeze, following the Lehman bankruptcy, after a subsidiary providing public sector financing, which had funded long-term projects via the capital markets – in many cases using very short-term money – was no longer able to obtain new funds. Banks and the government put together an aid package worth €35 billion, which shortly afterwards had to be increased to €50 billion.

● Setting-up of the Special Fund Financial Market Stabilization (SoFFin).

It soon became clear, however, that one-off solutions would not be sufficient in the long term to ensure the stability of the German financial system. The Federal Government therefore took the decision to establish the Special Fund Financial Market Stabilization



(SoFFin) on a temporary basis. The Financial Market Stabilization Act, the basis on which SoFFin was set up, was passed by both the Bundesrat (federal council) and Bundestag (German national parliament) on October 17, 2008. The aim of the act is to restore confidence in the financial system and to get banks to resume lending to each other again (interbank lending). The Fund can guarantee debt securities and liabilities of financial sector enterprises, provide financial institutions with additional regulatory capital resources and take on risk positions. Overall, the Fund can furnish government guarantees up to a total of €400 billion; up to €80 billion is available for recapitalisations and the taking up of risk positions.

By the end of the year, the Fund had granted four companies in the financial sector guarantees totalling €90 billion from the German government's bailout package; by the middle of April 2009, this figure stood at €130.2 billion for eight institutions. Positive decisions in principle had also been taken in favour of further institutions. In addition to this, by mid-April decisions were made on two recapitalisations totalling €18.7 billion. SoFFin has thus established itself as a key element in ensuring financial stability in Germany. For the time being though, it has not yet succeeded in permanently eliminating the liquidity bottlenecks and reviving the interbank market.

● BaFin bans short-selling.

This prevailing climate of great uncertainty and tension on the back of the Lehman bankruptcy opened the door to speculative bouts of market manipulation. In response to this, in September BaFin imposed a temporary ban on uncovered short-selling of selected financial stocks. The financial supervisory authorities of other countries followed suit and intervened in the capital markets, sometimes a great deal more forcefully. The British FSA, for instance, prohibited all transactions representing a short position in the sense of a negative economic exposure. In view of the ongoing market turmoil, BaFin extended the ban on short-selling to the end of May 2009.

● Spillover to other segments of the real estate market.

The US sub-prime crisis not only engulfed the credit and financial markets, but it also impacted negatively on other segments of the real estate market. In the USA, the sharp fall in house prices also saw increasing numbers of borrowers with a good credit rating experience financial difficulties, as a result of negative equity. In Europe, particularly the United Kingdom, Spain and Ireland were affected by the sharp falls on the residential real estate market. In Germany, on the other hand, residential property prices remained broadly stable in the absence of a price bubble developing in previous years.

The increasing reluctance shown by banks regarding the funding of large-scale projects with a high proportion of borrowed capital had a negative effect not least on the commercial real estate markets. Ventures were either postponed or scrapped. Many investors failed to secure follow-on financing as banks drastically tightened up the standards for the granting of loans and demanded much higher risk premiums compared to pre-crisis levels. Fire sales became

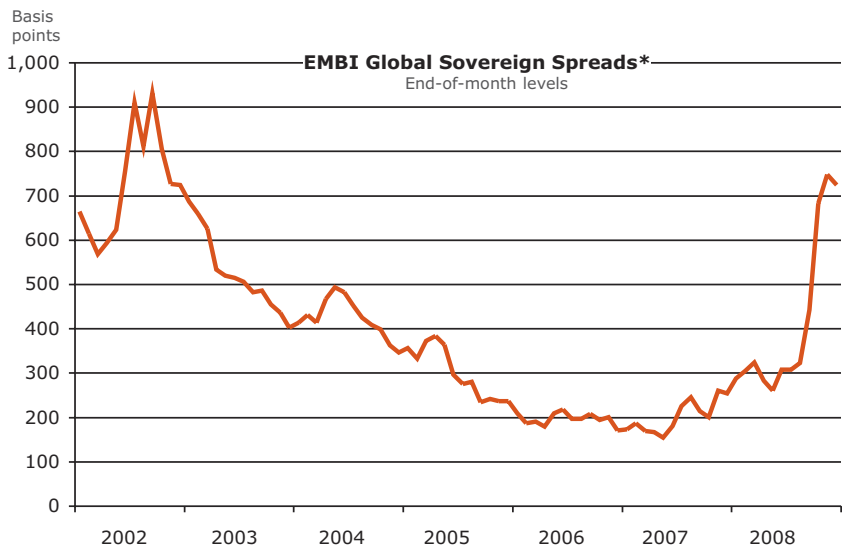
more and more common. The Anglo-Saxon commercial real estate markets were particularly badly hit as a result of the severely restricted capabilities of the capital markets. Here the price markdowns were comparatively large. One main reason for this could be that the issue of new Commercial Mortgage Backed Securities (CMBS), i.e. of structured securities collateralised by commercial real estate loans, came to a virtual standstill in 2008.

Upon spilling over to other national housing markets and markets for commercial property, the contagion from the US sub-prime crisis spread to further key segments of the Asset Backed Securities (ABS) market. Sharp downward corrections also had to be made to the value of these structured products on financial institutions' balance sheets. Even by the end of 2008, this process still had some way to go. Because of the close correlation between economic growth and the performance of the commercial real estate markets, further losses in the CMBS market as a result of the economic situation must be expected.

● Emerging markets caught up in the financial crisis.

Emerging markets too, which for a long time were extremely resilient in the face of the US sub-prime crisis, were in the end suddenly caught up in the increasing market turbulence in autumn 2008. Within the space of a few weeks, the risk premiums for government bonds from these countries compared to US papers shot up from around 300 basis points to over 700 basis points and reached their highest level since 2002.

Figure 1  
**Risk premiums for emerging market government bonds**



\* Emerging Markets Bond Index, spread versus US government bonds  
 Source: Bloomberg



The flight of investors to safe havens and the repatriation of funds to industrialised countries, where they were urgently needed to plug the holes in the wake of the financial crisis, caused this sudden mood change. Declining revenues of the oil producing countries due to the collapsing oil price, the sometimes high level of foreign indebtedness as well as growing economic concerns because of a number of emerging markets' high level of dependency on exports exacerbated this trend. Eastern European countries in particular had to wrestle with currency outflows and devaluations. Because of the major outflow of capital, Hungary, for instance, had to draw on an emergency loan running into double-digit billions in order to be able to meet its payment commitments. The funds were provided by the International Monetary Fund, the European Union and the World Bank in an effort to stabilise the Hungarian financial market and to restore investor confidence. In the meantime, a number of other countries around the world also turned to the Monetary Fund for help.

The problems affecting Iceland have exacerbated the already strained situation of emerging markets. Since 2003, the Icelandic banking system had experienced extremely strong growth through what were – for the most part – debt-financed acquisitions abroad. Ultimately, it grew so large that it was out of all proportion to the size of the country and its institutions were highly leveraged. When the country's biggest banks were no longer able to withstand the storm unleashed by the financial crisis and had to be nationalised, the small island state became overstretched and reliant on external help to stave off national bankruptcy. Many market participants used this event as an opportunity to reassess risks and to turn their backs on the emerging markets.

### Country risks

Compared with previous crises, the current financial turmoil is the first to have also seen supposedly safe debtors, such as the EU Member States of Hungary and Latvia, affected by liquidity problems. Against the background of globally linked capital markets, this development also has an impact as far as Germany is concerned. Foreign lending by German credit institutions has more or less tripled since 1999. Besides additional earnings potential, this increasing international exposure harbours a special category of risks which can be subsumed under the term "Country risks". This covers particular risks associated with foreign business which go beyond the mere risk of individual investment returns and instead can be reduced to the characteristics shared by virtually all of the commitments in a country.

Consistently high growth rates of up to 10% were a defining feature of the economic data of countries hit especially hard by the financial crisis, including in particular the emerging markets of Eastern Europe. As a result of the threatened downturn in the global economy, growth forecasts for 2009 were revised downwards across the board. As early as the third quarter of 2008,

Latvia – which still reported real growth of 10.3% in 2007 – recorded a 4.2% year-on-year fall in gross domestic product (GDP). An inflation rate well in excess of 10% bears out the assumption of an overheating economy. Against a background of historically low interest rates, the period of rapid economic growth tended to be accompanied by a high level of foreign indebtedness. In some countries, for example in Hungary, Latvia or Bulgaria, this rose to around 100% of GDP or more. In Iceland, the total debt of the now nationalised banks Kaupthing, Landsbanki and Glitnir positively ballooned, to reach a multiple of the country's economic output. Furthermore, buoyant domestic demand – as in the case of the Baltic States – led to substantial balance of trade and hence current account deficits.

Based on the resultant vulnerability of a number of countries, and the general loss of confidence, foreign investors decided to withdraw their capital from the affected markets. Consequently, some national stock markets went into freefall. For instance, the OMX Baltic 10, which tracks the price performance of the ten biggest and most liquid stocks in the Baltic region, at times recorded year-on-year falls of around 70%. In a number of places, for example on the Russian stock exchange, trading was suspended for several days. Outflows of funds and speculative attacks forced some currencies sharply lower. The value of the Hungarian forint was down 10% against the euro within the space of a few days while the Ukrainian hryvnia dropped by as much as 20% against the US dollar. Attempts to defend the national currency pushed interest rates up into double figures.

Where foreign currency reserves are too low, the countries affected have to resort to external liquidity aid in order to be able to service their foreign debt. As the table of concerted support measures below shows, recourse was mainly sought in credit lines extended by the International Monetary Fund (IMF).

Country	Total value of financial aid	IMF share	Credit sum as a % of GDP 2007
<b>Hungary</b>	\$25.0 billion	\$15.7 billion	18 %
<b>Ukraine</b>	\$16.9 billion	\$16.4 billion	12 %
<b>Latvia</b>	\$10.5 billion	\$2.4 billion	38 %
<b>Iceland</b>	\$10.2 billion	\$2.1 billion	51 %
<b>Pakistan</b>	\$7.6 billion	\$7.6 billion	5 %

By the end of 2008, the IMF had committed funds of around \$45 billion. Belarus and Serbia were also in concrete negotiations with the IMF. However, ratings downgrades at the end of 2008 look set to make the task of obtaining external finance considerably more difficult or, at least, more expensive. The country ratings for Romania and Russia were downgraded to so-called junk status.

Overall, market participants' risk assessment mostly reached its highest level at the end of October as a result of the financial difficulties experienced by individual banks and countries before the first (inter)national financial assistance and economic support programmes succeeded in calming investors' nerves in the short

term. Whether or not the confidence-boosting effect of these measures will be sustained remains to be seen given the continued pessimistic forecasts for the economy and the ongoing financial crisis.

● Outflows of funds hit hedge funds.

Towards the end of the year, it became more and more obvious that the escalating events on the markets had increasingly impacted on the hedge fund industry too, which had hitherto remained relatively unscathed by the financial crisis. The performance of the sector lurched deep into negative territory. In autumn 2008, the outflow of cash accelerated rapidly. A number of funds were forced to liquidate positions so as to meet customers' demands for repayment of the capital which they had invested, thereby exacerbating the downward trend on the financial markets. Hedge funds, which often operate with a high degree of leverage, are the prime example of the unavoidable yet painful process of deleveraging, which in 2008 affected almost all parts of the economy and put the financial markets under further pressure. Reducing indebtedness can often be achieved only by means of an emergency sale of assets which means that the risk of a self-perpetuating downward price spiral becomes ever more acute.

● Economy slumps.

In the face of huge losses and an erosion of the regulatory capital, banks were increasingly reluctant to provide high-risk loans. They tightened up the standards based on which credit was granted and demanded higher margins with the result that, for many companies and private households, borrowing not only became more difficult but also more expensive. Some investments were deferred and follow-up financing ground to a halt where investors were unable to provide sufficient regulatory capital. Following the example set by the United States, private households adopted a very conservative wait-and-see attitude, given the extremely uncertain environment. In terms of purchasing goods which were not an absolute necessity, consumers exercised restraint. As a result, the real economy bore the brunt of the financial crisis in the course of the second half of 2008. At first, it was the automotive industry in particular which suffered a sharp fall in demand but the slump quickly spread to other sectors. By the end of 2008, the global economy was facing an extraordinarily deep recession. The sheer extent and speed of the economic downturn, together with the way in which it spread to any number of regions at the same time, is unparalleled in post-war history.

● Concern regarding the considerable level of additional strain for the financial system brought about by the economic situation.

As a result of the global recession, the financial system, which had already been badly hit by the financial crisis, will be faced with major challenges. Even in 2008, the quality of credit deteriorated in many market segments. In this respect, too, the US set the pace. Having fallen to historically low levels in some instances during the previous years, defaults and difficulties with the servicing of loans increased. However, the downswing in the credit cycle is still in its early stages. With large parts of the world suffering from a weakening economy, default rates will continue to rise. Due to the fact that it is heavily dependent on exports, the German economy will be unable to escape the decline in global

trade. For the banks, this means that further write-downs are on the horizon. Institutions, which have already had to absorb high losses due to the sub-prime and financial crises, now face further pain in terms of their conventional lending business with corporate and private clients. The wave of loan defaults will also engulf those banks and savings banks which thus far have come off comparatively lightly in the financial crisis. As unemployment rises and growing numbers of companies become insolvent, insurers are having to adjust to higher lapse rates and to a reduction of income from premiums. The weak financial markets are, moreover, leading to impaired investment results. The business volumes of financial service providers and funds are suffering on the back of fewer transactions and a lower level of requirement for advice from investors as demand for complicated and high-risk investments falls due to the uncertain conditions. As a consequence, the economic slowdown can be expected to put a considerable strain on the financial system. Just how severe this will be depends on whether the extensive packages of monetary and fiscal policy measures will actually work and whether the impact of the economic slump can at least be cushioned.

● Global finance summit marks out framework for future regulation.

Amid the rapidly spreading turmoil on financial markets, the heads of government from the largest industrialised nations and emerging markets met in November 2008 at a G20 summit in order to discuss approaches for reforming the global financial system and to draw lessons from the sub-prime debacle. The agreement reached was centred on the systematic closing of supervisory loopholes and the further development of international cooperation between supervisory bodies. All financial markets, all financial products and all market participants are to be supervised and regulated. Taking rapid action to devise concrete and consistent measures is now key to implementing and embracing the 47-point action plan drafted at the global finance summit.

### Financial crisis: a chronology of important events in 2008

#### January

Several major international banks report losses running into billions for the fourth quarter of 2007.

The largest private US mortgage financier, **Countrywide**, is rescued by Bank of America.

The US Federal Reserve loosens monetary policy further and cuts its key interest rate to 3%. The US Congress passes a \$150 billion economic stimulus plan.

#### February

The British mortgage financier **Northern Rock** is nationalised following several failed sales attempts.

#### March

The US investment bank **Bear Stearns** gets into difficulties and is acquired by JP Morgan in an emergency sale.

The US Federal Reserve cuts its key interest rate to 2.25% and expands the range of refinancing facilities.

#### April

The wave of write-downs continues. Many major banks post record losses for the first quarter of 2008.

#### May

The world's leading central banks jointly announce further measures to provide the markets with US dollar liquidity.

#### June

Several major US financial institutions report heavy losses in the second quarter of 2008.

#### July

The US mortgage bank **IndyMac** is closed down.

The US government props up the two largest, semi-nationalised real estate financiers **Fannie Mae** and **Freddie Mac**.

#### August

The Kreditanstalt für Wiederaufbau (KfW) sells its stake in **IKB** to the financial investor Lone Star.

#### September

The US investment bank **Lehman Brothers** goes bankrupt and is abandoned. The collapse has a dramatic effect, further hitting confidence among banks. The interbank market dries up.

The US Federal Reserve grants **AIG**, once the world's largest insurer, an emergency loan of \$85 billion, effectively nationalising it in the process.

**Fannie Mae** and **Freddie Mac** are placed under government administration.

**Merrill Lynch** seeks refuge in the arms of Bank of America.

**Goldman Sachs** and **Morgan Stanley** are converted into ordinary commercial banks in order to benefit from the Federal Reserve's credit supply. The era of US investment banks comes to an end.

The largest US savings bank **Washington Mutual** is no longer able to meet its commitments as a result of heavy losses from the mortgage business. JP Morgan acquires the parts of the institution's business that still have some value.

The fourth largest US bank **Wachovia** flounders. Following an intense bidding war, it is finally sold to Wells Fargo.

The British real estate financier **HBOS** is taken over by Lloyds TSB.

The Benelux countries come to the aid of **Fortis**. Shortly afterwards, the group is broken up.

The Irish government provides a comprehensive deposit guarantee for the country's six major banks. Subsequently, several European countries, including Germany, promise to fully guarantee personal savings deposits or raise individual deposit guarantee levels.

Liquidity problems at its subsidiary Depfa leave **Hypo Real Estate** teetering on the brink. Banks and the German government grant a credit line and provide guarantees. A few days later, the bailout package has to be increased to €50 billion.

**BaFin** and other financial supervisory authorities impose a ban on uncovered **short sales** of financial stocks.

### October

In the US, a **\$700 billion rescue package** is rapidly put in place for the banks.

The **real economy** feels the full force of the financial crisis. Sales in the automotive industry slump worldwide.

In **Iceland**, the oversized banking system falters and has to be propped up by the government. The country is faced with bankruptcy.

**Emerging markets** are getting increasingly caught up in the financial crisis. The IMF provides **Hungary** with an emergency loan.

The world's leading central banks take concerted steps to cut key interest rates.

In Germany, a Special Fund Financial Market Stabilization (**SoFFin**) is set up which can provide banks with capital of up to €80 billion and guarantees of up to €400 billion. Other European countries adopt similar rescue programmes.

Several German **open-ended real estate funds** experience liquidity problems and have to be closed.

### November

At a **global finance summit**, the heads of government from 20 industrialised nations and emerging markets agree on the target of full regulation of financial markets.

Rapid outflows of cash hit the **hedge fund** industry.

The US government props up the major bank **Citigroup** with a capital injection of \$20 billion and guarantees of \$306 billion for toxic assets.

The US Federal Reserve announces that it intends to intervene in the markets directly by purchasing ABS, which are collateralised by consumer loans and mortgages. The programmes, totalling \$800 billion, are designed to get credit flowing again.

### December

Most economists revise their economic forecasts downward sharply. It becomes clear that the global economy is set to face its deepest **recession** since the Second World War.

The EU heads of government agree on a €200 billion **economic stimulus plan**. In the US, Barack Obama, the newly-elected President, aims to boost the economy with an aid package worth up to \$700 billion. China too takes large-scale measures to underpin its economy.

The investment company of the former Nasdaq chairman **Madoff** is reported to have defrauded investors of \$50 billion through a classic Ponzi scheme.

The leading central banks loosen their expansive monetary policy further. The US Federal Reserve and the ECB cut their key interest rates, from 1% to 0-0.25% and from 3.25% to 2.5% respectively.

## 2 Financial markets

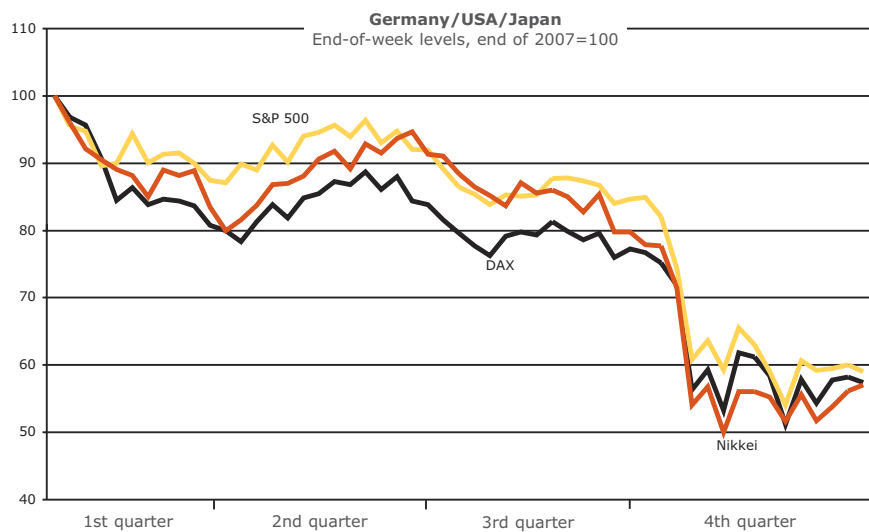
● Financial crisis spreads to real economy.

In 2008, the US sub-prime crisis first affected the entire banking system before spreading to all areas of the economy. The credit and bond markets were particularly badly hit by the crisis. Corporate bond spreads soared. Banks' willingness to lend to other institutions decreased steadily and capital flows dried up. Stock indices fell at the start of 2008, primarily pushed lower by financial stocks, before staging a marked recovery in March and April. However, following the collapse of the US investment bank Lehman Brothers, the second half of the year was characterised by a widespread erosion of stock prices. The uncertainty regarding the way in which the economy as a whole was likely to develop caused unheard of volatility on global stock markets. The financial crisis no longer remained confined to the capital markets, but instead spread to other sectors.

● Erosion of prices on the stock markets.

Rising commodity prices, the prospects of subdued economic activity and, not least, the lingering financial crisis prompted investors to take profits. A distinct appetite for selling on the part of investors was therefore the defining feature of the stock markets during the first two months of the year. Stock indices fell from their high levels – even more markedly in Europe and Japan than in the USA. The numerous individual bank crises then triggered a second massive collapse in prices at the start of October. Reports that most industrialised nations were anticipating not just lower levels of growth but actually a recession intensified this downward trend, thus ruling out any prospect of a recovery in prices anytime soon. Overall, the value of the MSCI World Index fell by 42% from the beginning until the end of the year, while the annual loss recorded by the Dow Jones Index stood at 34%.

Figure 2  
**Stock markets in comparison, 2008**



Source: Bloomberg

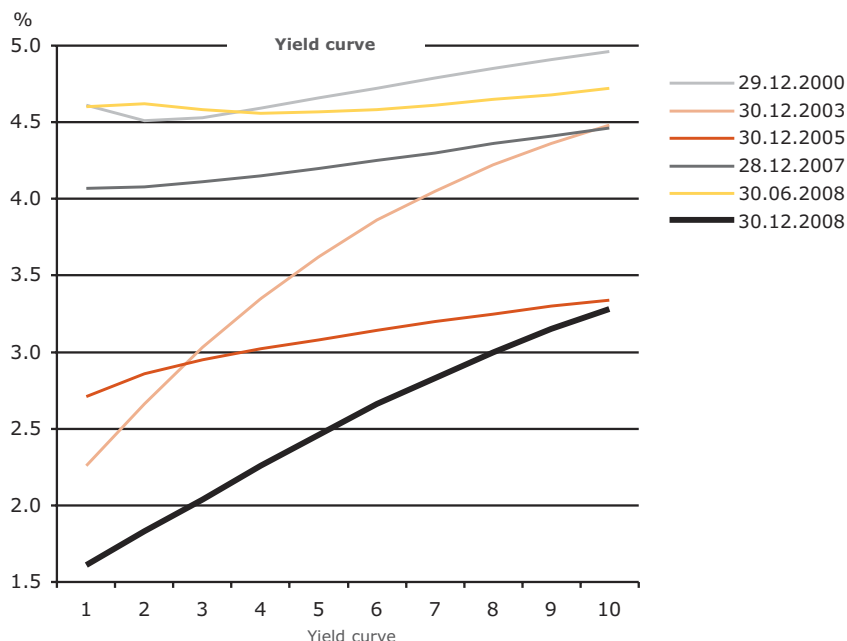
● Negative economic outlook forces DAX lower.

In 2008, the DAX performed worse than the S&P 500. Having produced a much more positive performance in the previous year due to the better economic situation in Germany, the poor outlook for the second half of 2008 and the following year now held sway. In mid-November, the DAX hit bottom not far short of the 4,000-point mark, after starting the year at almost 8,000. After recording GDP growth of 2.5% in 2007, the German economy slowed to a mere 1.3% in 2008. The VDAX volatility index rose at the end of September and soared to highs of more than 60 basis points in mid-October and at the end of November.

● Marked downward shift in the yield curve.

The yield curve was subject to a great deal of movement in 2008. It sloped upwards until the middle of the year, but was flatter than at the end of 2007, and even displayed a negative slope at times. As the year progressed, the crises at numerous banks and the ensuing major uncertainty on the markets resulted in a flight towards investments such as government bonds or precious metals. As a result, the yield curve – based on government bond yields – sloped downwards markedly at the end of the year and once again displayed a steep course.

Figure 3  
Yield curve on the German bond market\*



\* Interest rates for (hypothetical) zero bonds without loan loss risk  
Source: Bloomberg

● Central banks cut key interest rates.

Besides investors seeking refuge in safe havens, another key factor in the marked shift in the yield curve were the deep cuts in the key interest rate made by central banks. Although, at the start of the year, central banks had used additional facilities to try to offset the reduction in capital flows on the interbank market and to prevent liquidity from drying up, later on in the year many countries had to put in place rescue packages with capital participations or



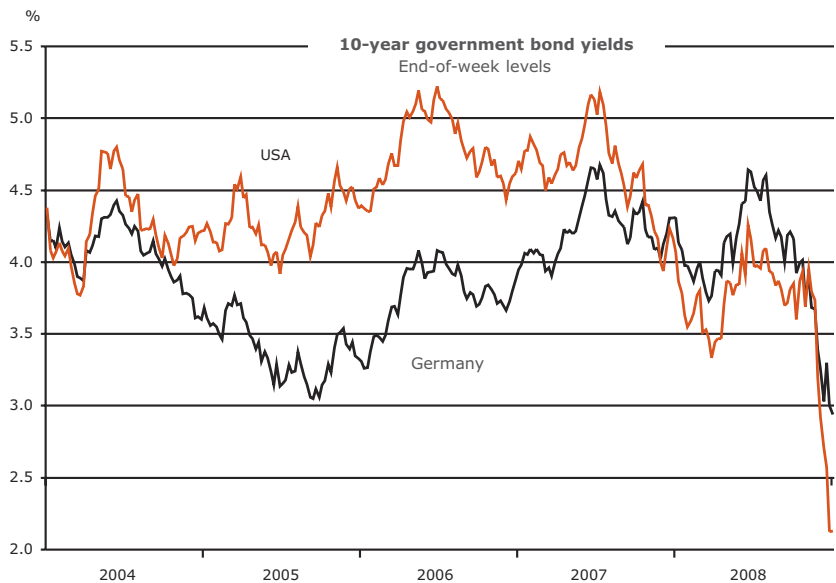
● Government bond yields fall on the back of interest rate cuts and high demand.

government guarantees in order to ensure that banks had sufficient levels of liquidity. As commodity prices plummeted during the second half of the year, thereby easing inflationary pressures, central banks were able to respond to the financial crisis and the gloomy economic forecasts with a series of key interest rate cuts. The US Federal Reserve lowered its key interest rate from 4.5% at the start of the year to 0.25% by year-end. The key rate for the euro was cut from 4% to 2.5%.

Over the year, the trend in yields on long-term government bonds in Germany and the US was similar. During the first three quarters, the rate of interest paid by the US on its government securities was still lower than in Germany, but by the end of the year, following a massive change in the key interest rate, the rates largely converged. It is remarkable that, in spite of the high level of capital requirement triggered by the rescue packages and the associated increased issue of government securities, interest rates could fall as they did. The search for safe investments undoubtedly played a decisive role in this respect.

Figure 4

**Comparison of capital market returns in USA and Germany**

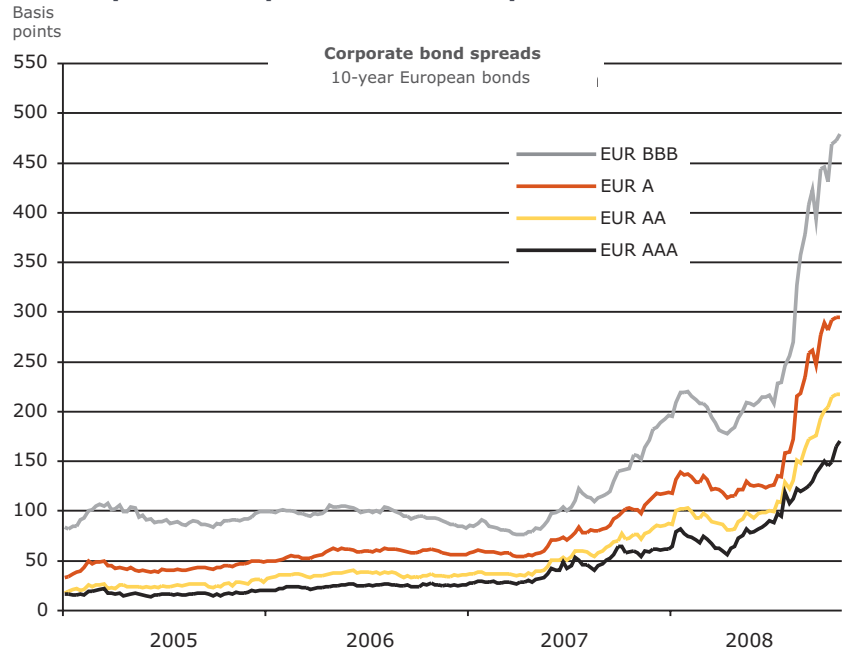


Source: Bloomberg

● Precipitous rise in spreads.

The increasing reluctance shown by investors caused risk premiums to rise sharply, especially for complex risk products. The market for debt-financed corporate acquisitions came to a virtual standstill. European corporate credit spreads, which had already widened in 2007, increased sharply during the second half of 2008. For instance, the spreads on AAA-rated bonds as against comparable government bonds tripled from approximately 50 basis points to around 150 basis points. This in turn caused financing conditions to deteriorate considerably, even for financially sound companies.

Figure 5  
**Development of spreads in the corporate sector**



Source: Bloomberg

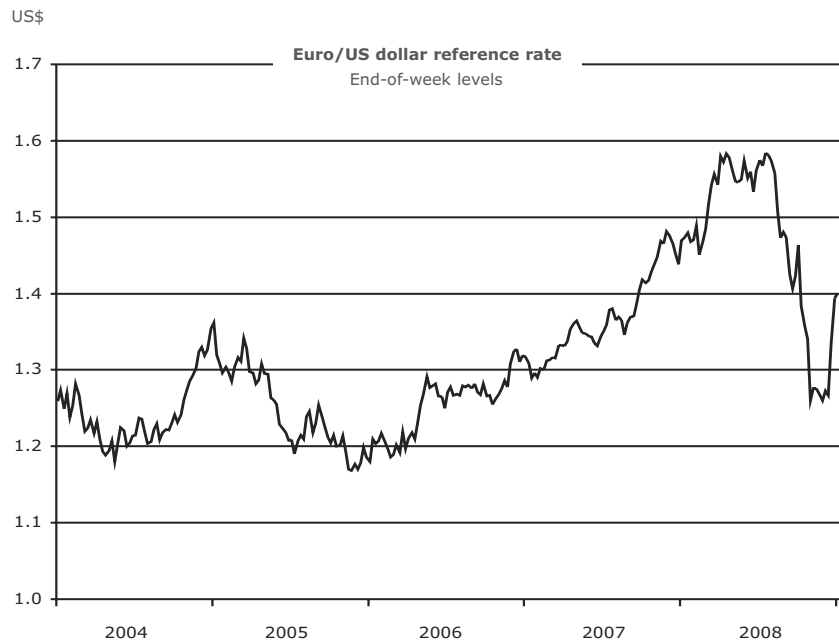
● More difficult refinancing conditions for companies.

There was an increase in the perceived probabilities of defaults corporate bonds, due in particular to the negative expectations regarding the economy. In addition to poor sales opportunities, companies are therefore also faced with tougher refinancing conditions. Banks also raised their standards for the granting of loans, albeit less so in Germany than in the euro area as a whole.

● US dollar shows strength.

The euro peaked against the US dollar during the first six months of 2008. However, once the real economic consequences of the financial crisis for Europe became increasingly clear, the second half of the year saw the euro tumble. It was not until the second half of December, when the US Federal Reserve departed from conventional monetary policy and announced its zero rate interest policy that the euro recovered.

Figure 6

**Exchange rate development**

Source: Bloomberg

### 3 Banks

● Financial crisis has marked implications for banks.

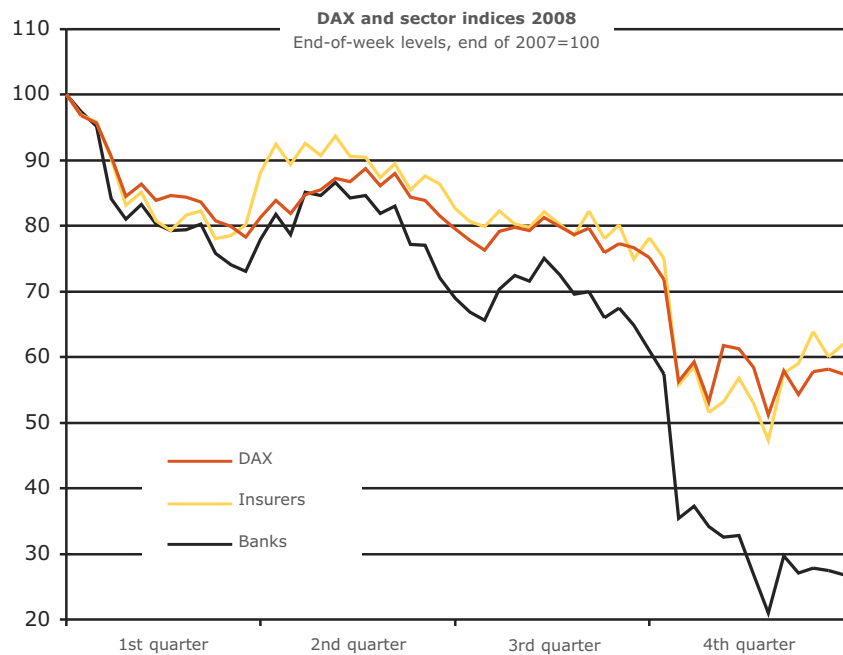
As in the previous year, the situation of the banks reflected the consequences of the sub-prime crisis and the resultant global financial and economic crisis. Positions in securitisation structures caused considerable losses for German banks due to the collapse in prices on the US housing market. With the crisis spilling over to virtually all asset classes, heavy losses were now also being incurred from other securitisations and investments. The lack of liquidity in sub-segments of the money and capital market also exacerbated the banks' situation. In particular, the limited possibility to either raise or extend additional refinancing capital, caused banks problems. This affected not just banks with sizeable investments in US sub-prime securities or other high-risk investments but all credit institutions. For institutions with no access to refinancing arrangements from the European Central Bank, this proved particularly problematic.

● Financial stocks push DAX lower.

The implications of the financial crisis for the financial industry are clearly shown by market indicators. In addition to the general slowdown in economic activity, it was most notably the performance of financial stocks which depressed the value of the DAX blue chip index. As a complement to the mandatory reporting for regulatory purposes, market indicators provide an up-to-date reflection – in contrast to balance-sheet key figures – of sentiment among market participants regarding the future development of a

company, thus providing valuable additional information for regulators. The DAX fell by around 38% during the course of 2008. While the sector index for German insurers recorded a similarly significant decline (around 43%), the sector index for German banks was actually down by over 70% compared to its value at the start of the year.

Figure 7

**German financial sector stock indices**

Source: Bloomberg

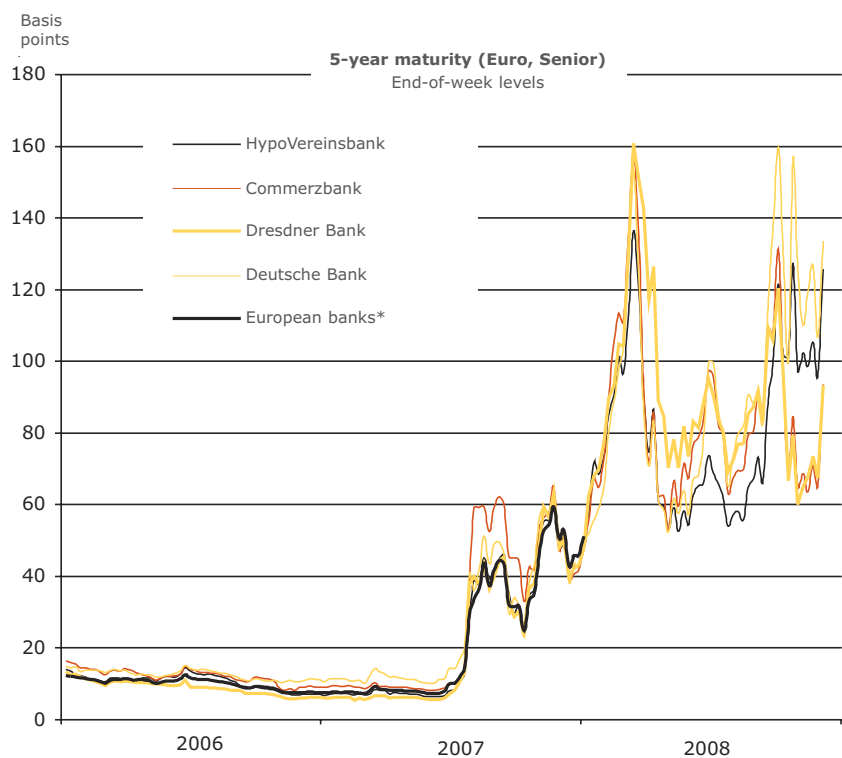
● CDS spreads fluctuate widely.

The uncertainty is particularly clear in rocketing credit default swap (CDS) spreads.<sup>2</sup> As early as mid-2007, the CDS spreads of German banks rose from a historical low of below ten basis points to more than 60 basis points in some cases. As 2008 progressed, CDS spreads fluctuated widely. At the time of the takeover of Bear Stearns in March 2008, premiums of up to 160 basis points were paid on the credit derivatives markets for German institutions. At this point, CDS spreads on US financial institutions climbed to more than 400 basis points. Once a number of guarantees had been accepted for Bear Stearns, the CDS spreads of financial institutions tightened worldwide by mid-2008. Nevertheless, the fact that credit default swaps remained at a high level in mid-2008 only served to illustrate the ongoing sense of uncertainty. The situation worsened again in September. Negative news regarding US companies such as AIG, Lehman or the two mortgage banks

<sup>2</sup> CDS spreads are OTC market prices for assuming the default risk on a loan granted to a company. Only the risk is traded, not the entire loan. Spreads are generally given in basis points. A spread of 120 basis points means that where the volume of a contract is €100 million, the annual premium to be paid is €1.2 million (1.2% of €100 million). The greater the risk, the higher the spread.

Freddie Mac and Fannie Mae, was mirrored in historical highs for CDS spreads. Although the extent of the increase in the spreads on German institutions was not as marked as that on US banks, values of up to 160 basis points were once again recorded. At the end of the year, the passing of the Financial Market Stabilization Act caused the premiums for credit default risks to fall again. The continued high level, however, highlights the uncertainty which remained even at the end of the year.

Figure 8  
**Credit default swap spreads for Germany's major banks**



\* Unweighted average of CDS spreads for 16 major European banks.

Source: Bloomberg, BaFin calculations

● Varied impact of the lack of liquidity in the interbank market.

Following the collapse of Lehman, a sense of mutual mistrust dominated the interbank market, which in turn virtually dried up. The major commercial banks and the Landesbanks suffered most from the lack of liquidity, whereas the situation for savings banks and cooperative banks (Genossenschaftsbanken) looked less serious. Many private customers transferred their financial assets – even after the liquidation of high-risk investment instruments – to the retail banks. Focusing on retail and private customers proved to be a more viable business model during the crisis. This gave institutions a favourable source of refinancing instead of having to rely exclusively on the capital market. Savings banks and cooperative banks in particular recorded considerable inflows of funds from private customers during the crisis, as these were perceived by the public to be safer than major or direct banks.

Nevertheless, developments among leading institutions may also impact on the primary banks. For instance, problems at the Landesbanks had a knock-on effect on savings banks. Yet the tight liquidity situation and the increasingly gloomy outlook for the economy also affected some smaller specialist institutions, such as automotive finance providers.

● Banks tighten up credit standards.

At banks, the recession is having an impact on the granting of credit as well as on the default rate of their credit portfolios. According to a survey carried out by the European Central Bank, the regulations governing the granting of credit became much more stringent in the euro area in the course of 2008. In Germany, institutions only began to significantly tighten up the standards for the granting of credit from the third quarter onwards. In the rest of the euro area, this move was considerably more marked. The institutions cited economic developments as the reason for the more stringent standards rather than the financial crisis.

● Growing process of banking consolidation expected.

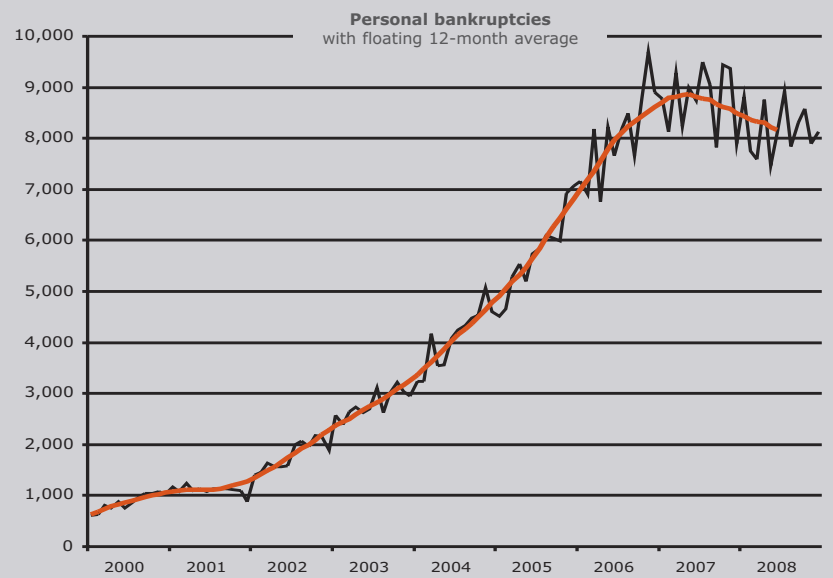
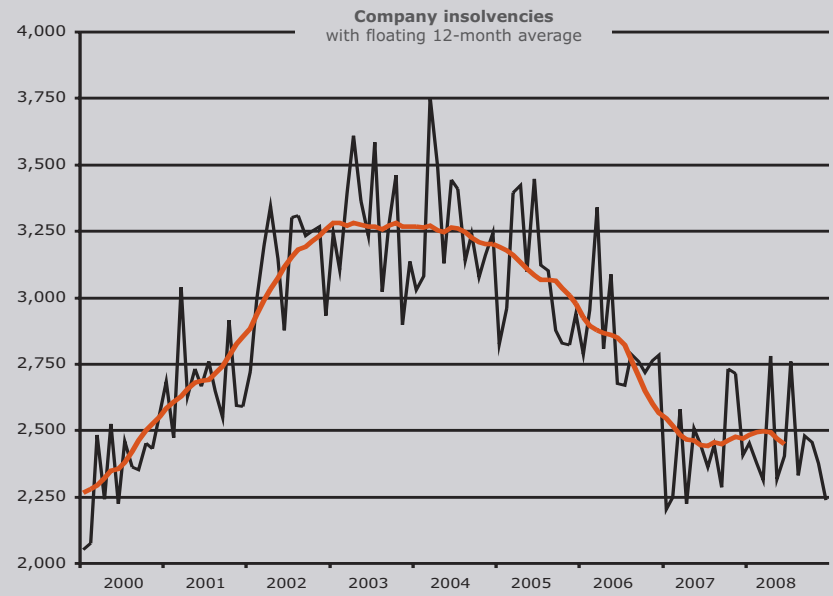
There will be further consolidation in the German banking market in the medium term. 2008 already saw a number of takeovers. Commerzbank bought large parts of Dresdner Bank, while Deutsche Bank acquired a stake in Postbank. Citibank Deutschland was sold to the French cooperative bank Crédit Mutuel. Talks were held between the Landesbanks with a view to bringing about consolidation that would leave just two or three institutions. Special purpose vehicles will have to be included in the scope of consolidation to the greatest possible extent. This reduces the institutions' opportunity for supervisory arbitrage and increases the supervisory risks to be covered by the capital.

### Change in number of insolvency cases

On average, the number of corporate insolvencies rose only slightly. In 2008, 29,291 companies failed – around 0.5% more than in the previous year. The associated probable claims of creditors rose by 22% to around €22 billion in the course of the year. The economic downturn suggests that lending is falling and insolvencies are increasing further. As far as banks are concerned, this means that interest income is set to fall and losses may be incurred as a result of loan defaults.

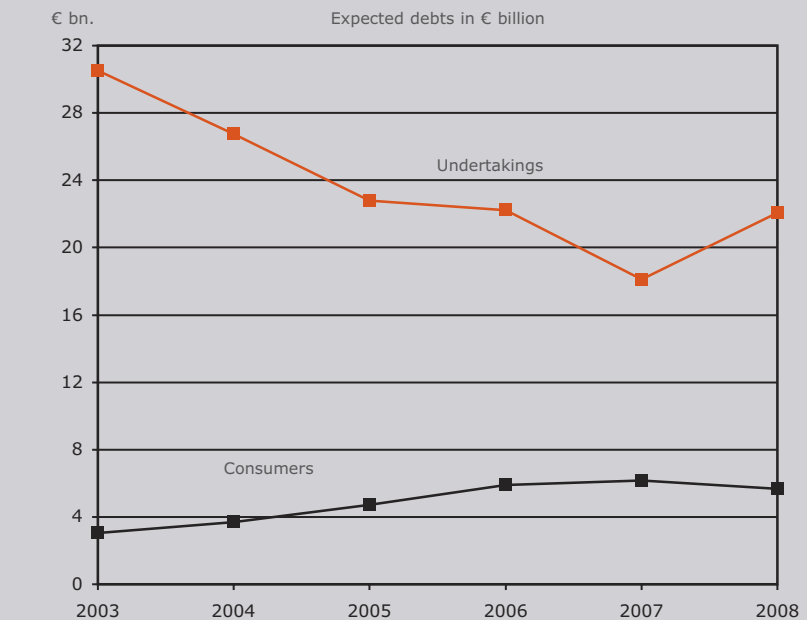
In 2008, the number of personal bankruptcies fell by 7% to 98,140. The probable claims also fell by around 8% and now stand at €5.7 billion. These claims may continue to be significantly lower than those in the corporate sector, but they might already be turning into an obstacle in terms of the granting of consumer credit and will probably lead to even more risk-conscious pricing.

Figure 9  
**Number of insolvencies**



Source: Federal Statistical Office

Figure 10  
**Volume of claims**



Source: Federal Statistical Office

## 4 Insurers

- Financial market crisis reaches the insurance sector.

Although a conservative investment policy ensured that German insurers had little exposure to sub-prime risks, the sector failed to escape the global fallout. The uncertainty on the capital markets over the past 18 months, coupled with falling capital earnings and the general economic climate also impacted on the performance of the German insurance industry. Nevertheless, the consequences for the insurance sector were manageable in 2008 and permitted modest growth.

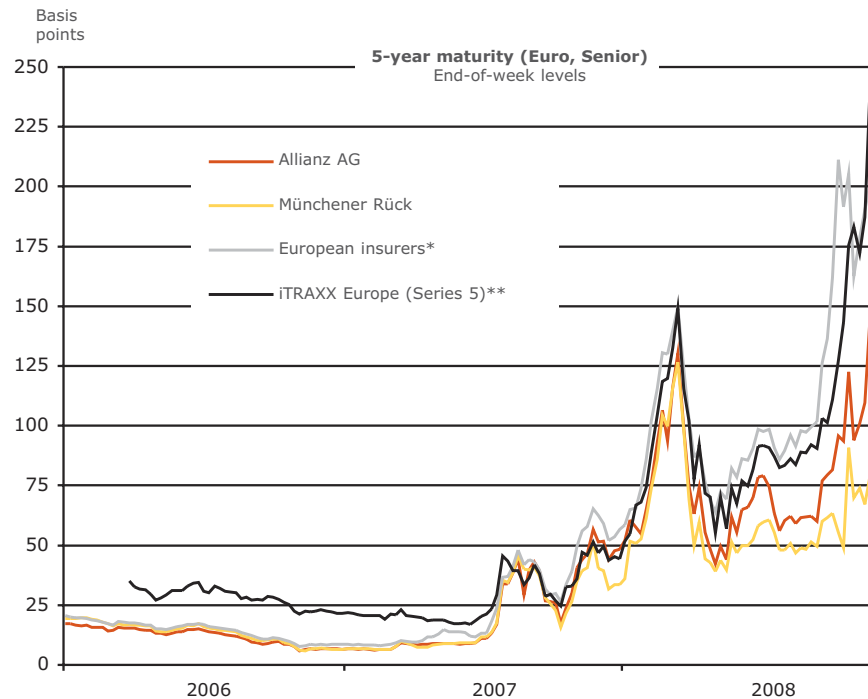
The downside in share prices on the DAX was also reflected in the stock index of the insurance sector. However, stock market volatility hit the banking sector harder than the insurance sector, whose index was down by a smaller percentage than the DAX at the end of the year.

- Risk premiums of German insurers rose to a record high.

Credit default swap spreads for insurance companies were relatively high as early as the end of 2007. During the first quarter of 2008, they increased further and briefly exceeded the mark of 100 basis points. Following a recovery in the intervening period, the end of the year saw a very sharp increase in risk premiums. On the whole, the market still considered German insurers to be better placed in terms of solvency than their international competitors.



Figure 11  
**Credit default swap spreads of selected insurers**



\* Unweighted average of the nine most liquid CDS spreads of European insurers.  
 \*\* Unweighted average of the 125 most liquid DS spreads over the six months prior to publication of series 5 of the index (in March 2006).  
 Source: Bloomberg, BaFin calculations

● Assessment of rating agencies: modest, but stable.

Although the ratings agencies' assessment of German insurance companies tended to be positive between 2004 and 2007, this trend was reversed in 2008, with downgrades outnumbering upgrades. The ratings outlook for German primary insurers and reinsurers was, however, mainly stable; few recorded positive ratings and a number of them negative ones. The outlooks of the ratings agencies for the corresponding segments were also largely stable.

● Slight fall in equity ratio.

In 2008, total investment by all German primary insurance companies increased by 0.4% to €1,084 billion compared to the previous year. The largest investment block continued to be accounted for by fixed-income investments. Loans, Pfandbriefe, municipal bonds and other bonds from credit institutions took for the lion's share of total investments. The equity ratio of the primary insurers fell slightly in 2008 compared to the previous year, a trend which was repeated in the equity ratio in the life insurance sector. The comparatively low equity ratios meant that German insurance companies were relatively stable in financial terms, despite the sharp fall in stock prices. The hedge fund investments of German insurers continued to be well below the regulatory maximum level of 5% of capital investments. The total investment by German primary insurers in hedge funds in 2008 accounted for around 0.5% of total capital investments.

- Financial crisis affects economic performance of primary insurers.



At the end of 2008, the yield on ten-year government bonds dropped below the 3% mark, less than the previous low recorded in 2005. This had a detrimental effect on the earnings of life insurers from new investment in fixed-income securities. In the middle of the year, the interest rate level was still around 4% but declined markedly as a result of the financial crisis. The guaranteed rate of interest had already been reduced well before that. Since this reduction only applies to new policies, its impact on the interest to be generated by the insurance companies will take some time to feed through. Following another positive performance in the earnings situation of the property and casualty insurance segment in 2007, a negative trend was recorded in 2008. Fierce price competition in the motor vehicle insurance segment once again resulted in a slight fall in premium income.

- Favourable trend in claims improves economic situation for reinsurers.

Although a number of fairly major natural disasters occurred in 2007, reinsurers managed to once again slightly increase their returns on equity. The adjustments to the risk assessment and risk models clearly had a positive impact. The financial situation of the global reinsurance sector in 2008 was probably affected more by the financial crisis rather than insurance claims. Nevertheless, claims events such as hurricanes Gustav and Ike will have an effect on the results of reinsurers. Despite the turmoil on capital markets, the ratings agencies continued to confirm the stable financial strength of the reinsurers.

Table 1

## Economy and financial sector overview for Germany\*

<b>Selected economic data</b>	Units	2002	2003	2004	2005	2006	2007	2008
GDP growth <sup>1)</sup>								
Global economy	%	3.0	4.1	5.3	4.8	5.4	4.9	3.4
USA	%	1.6	2.5	3.9	3.2	2.9	2.2	1.3
Euro area	%	0.9	0.8	2.1	1.3	2.7	2.6	1.2
Germany	%	0.0	- 0.2	1.1	0.8	2.9	2.5	1.3
Corporate insolvencies	number	37,579	39,320	39,213	36,843	34,137	29,160	16,573
DAX (end of 1987=1000) <sup>2)</sup>	points	2,893	3,965	4,256	5,408	6,597	8,067	4,810
Interest rate money market <sup>3)</sup>	%	3.32	2.33	2.11	2.19	3.73	4.69	2.89
Interest rate capital market <sup>3)</sup>	%	4.81	4.08	4.04	3.36	3.95	4.31	3.28
Exchange rate of the €	1 €=...\$	0.95	1.13	1.24	1.24	1.32	1.47	1.39
Gross sale of fixed-income securities <sup>4)</sup>	€ bn.	819	959	990	989	926	1,022	1,337
<b>Credit institutions</b>								
Credit institutions <sup>5) 5)</sup>	number	2,593	2,466	2,400	2,349	2,301	2,277	2,154
Branches <sup>5) 5)</sup>	number	50,868	47,244	45,467	47,333	40,332	39,838	
Credit loans <sup>6) 6)</sup>	€ bn.	2,241	2,242	2,224	2,227	2,242	2,289	2,358
Net interest margin <sup>7)</sup>	%	1.20	1.16	1.18	1.17	1.15	1.12	
Commission surplus	€ bn.	24.3	24.4	25.3	27.8	29.9	31.7	
Operational costs	€ bn.	78.3	77.3	75.8	78.8	81.5	81.6	
Risk provisioning	€ bn.	31.2	21.8	17.2	14.1	14.0	23.5	
Cost-income ratio <sup>8)</sup>	%	67.2	66.5	65.5	61.0	62.3	65.0	
RoE <sup>9)</sup>	%	4.5	0.7	4.2	13.0	9.4	6.6	
Solvency ratio <sup>10) 22)</sup>	%	12.8	13.4	13.3	13.1	13.3	12.5	14.0
<b>Private banks</b>								
Credit loans <sup>6) 6)</sup>	€ bn.	594	579	575	580	587	627	662
Net interest received <sup>7)</sup>	%	1.34	1.17	1.25	1.27	1.33	1.30	
Cost-income ratio <sup>8)</sup>	%	74.2	74.0	73.5	59.8	66.0	65.5	
RoE <sup>9)</sup>	%	1.0	- 6.2	- 0.4	21.8	11.2	19.1	
Solvency ratio <sup>10) 21)</sup>	%	14.4	14.5	13.7	12.7	13.7	11.8	13.2
<b>Savings banks</b>								
Credit loans <sup>6) 6)</sup>	€ bn.	572	577	573	574	576	578	589
Net interest received <sup>7)</sup>	%	2.38	2.40	2.35	2.30	2.23	2.03	1.96
Cost-income ratio <sup>8)</sup>	%	66.5	66.4	64.9	66.0	65.8	65.4	67.4
RoE <sup>9)</sup>	%	8.2	10.9	9.7	10.4	8.9	7.2	4.8
Solvency ratio <sup>10) 10)</sup>	%	11.2	11.5	12.1	12.6	13.1	13.1	14.4
<b>Credit unions</b>								
Credit loans <sup>6) 6)</sup>	€ bn.	335	338	342	348	353	360	369
Net interest received <sup>7)</sup>	%	2.49	2.51	2.51	2.46	2.30	2.15	2.05
Cost-income ratio <sup>8)</sup>	%	73.1	69.6	68.7	70.0	64.3	70.5	73.2
RoE <sup>9)</sup>	%	9.7	10.6	10.3	13.8	11	8.1	5.7
Solvency ratio <sup>10) 10)</sup>	%	11.0	11.7	12.1	12.2	12.2	12.8	14.2
<b>Insurance companies</b>								
<b>Life insurance companies</b>								
Hidden reserves in the investment portfolio (IP) <sup>11)</sup>	€ bn.	6.2	14.9	35.6	44.0	35.2	14.7	10.4
as % of IP book value	%	1.1	2.4	5.5	6.5	5.3	2.0	1.5
Ratio of fund units in IP <sup>12)</sup>	%	23.0	23.3	22.0	23.2	23.1	22.7	24.3
Ratio of borrower's notes and loans in IP <sup>12)</sup>	%	18.1	19.3	22.0	22.2	23	21.9	
Net rate of return on IP <sup>13)</sup>	%	4.4	5.0	4.8	5.0	5.4	4.5	
Net technical provisions	€ bn.	502.8	520.6	536.2	551.2	566.5	583.8	
as % of balance sheet totals	%	83.8	79.4	78.8	78.1	77.3	75.0	
Surplus <sup>14)</sup>	€ bn.	5.1	9.2	9.7	14.2	14.1	13.5	
as % of gross premiums earned	%	7.9	13.6	14.1	19.5	18.8	17.8	
Eligible own funds (A+B+C)	€ bn.	39.8	42.3	43.9	49.1	54.6	57.5	
Solvency margin <sup>15)</sup>	€ bn.	23.3	24.0	24.8	25.9	26.8	27.8	
Coverage of solvency margin <sup>16)</sup>	%	170.4	176.2	177.4	190.0	203.8	206.8	
Return on net worth <sup>17)</sup>	%	3.4	5.7	5.8	9.7	9.5	8.8	
<b>Property and casualty insurance companies</b>								
Hidden reserves in the investment portfolio (IP) <sup>11)</sup>	€ bn.	22.3	26.0	26.6	27.7	29.8	28.9	21.7
as % of IP book value	%	21.3	23.8	22.6	22.2	22.4	20.7	15.8
Ratio of fund units in IP <sup>12)</sup>	%	27.0	27.3	26.5	29.8	30.5	31.0	30.3
Ratio of borrower's notes and loans in IP <sup>12)</sup>	%	13.2	14.1	16.6	18.3	15.6	19.4	
Net combined ratio <sup>18)</sup>	%	103.2	94.7	92.2	92.6	90.6	103.1	
Eligible own funds (A+B)	€ bn.	25.0	27.1	24.1	22.5	27.4	28.3	
Solvency margin <sup>15)</sup>	€ bn.	7.4	7.8	8.4	8.8	8.8	8.8	
Coverage of solvency margin <sup>16)</sup>	%	336.9	346.0	286.3	255.3	310.7	321.6	
Return on net worth <sup>17)</sup>	%	2.8	4.2	3.0	4.5	4.6	4.1	
<b>Reinsurance companies</b>								
Hidden reserves in the investment portfolio (IP) <sup>11)</sup>	€ bn.	35.8	34.3	37.2	49.9	57.7	63.6	34.5
as % of IP book value	%	18.5	15.6	17.2	22.0	26.4	33.9	16.0
Net combined ratio <sup>18)</sup>	%	101.6	92.8	93.5	93.8	89.2	84.2	
Eligible own funds (A+B)	€ bn.	-	-	-	-	-	66.3	
Solvency margin	€ bn.	-	-	-	-	-	-	5.8
Gross actuarial reserves	€ bn.	130.6	135.8	140.8	154.4	143.1	131.1	
as % of gross premium income	%	244	264.4	298.5	340.0	330.3	329.7	
Net profit for the year <sup>19)</sup>	€ bn.	5.4	1.4	3.4	1.8	7.3	8.0	
Available regulatory capital <sup>20)</sup>	€ bn.	40.2	51.4	55.1	57.6	66.3	71.0	
Return on net worth <sup>17)</sup>	%	13.3	2.7	6.1	3.1	11.0	11.2	

Sources: BaFin, Deutsche Bundesbank, Eurostat, IMF

\* Annual totals or averages, unless otherwise specified

a) Year-end level

1) Year-on-year change in real GDP.

2) 3-month Euribor.

3) 10-year government bond yields.

4) Domestic issuers.

5) According to section 1 (1) KWG (including Postbank, investment companies and all branches of foreign banks).

6) Current account loans to domestic companies and private individuals.

7) Net interest income as percentage of total assets.

8) Administrative expenses in relation to operational income.

9) net profit before taxes as percentage of the average reported regulatory capital.

10) Liable regulatory capital in relation to weighted risk assets (solvency indicator pursuant to Principle I).

11) Fair values – book values of entire investment portfolio (IP).

12) Percentage of total IP excluding deposits with ceding undertakings.

13) (Returns on IP - expenses for IP) / arithmetic mean of IP (beginning/end of year).

14) Net profit for the year + gross expenses for bonuses and rebates.

15) Minimum own funds free of foreseeable liabilities.

16) Eligible own funds/ solvency margin.

17) Net profit for the year / regulatory capital.

18) Net expenses for claims and insurance operations / net premiums earned.

19) Corresponds to item II.14 form 2 RechVersV.

20) Total regulatory capital - unpaid capital contributions.

21) Major banks only from 2007.

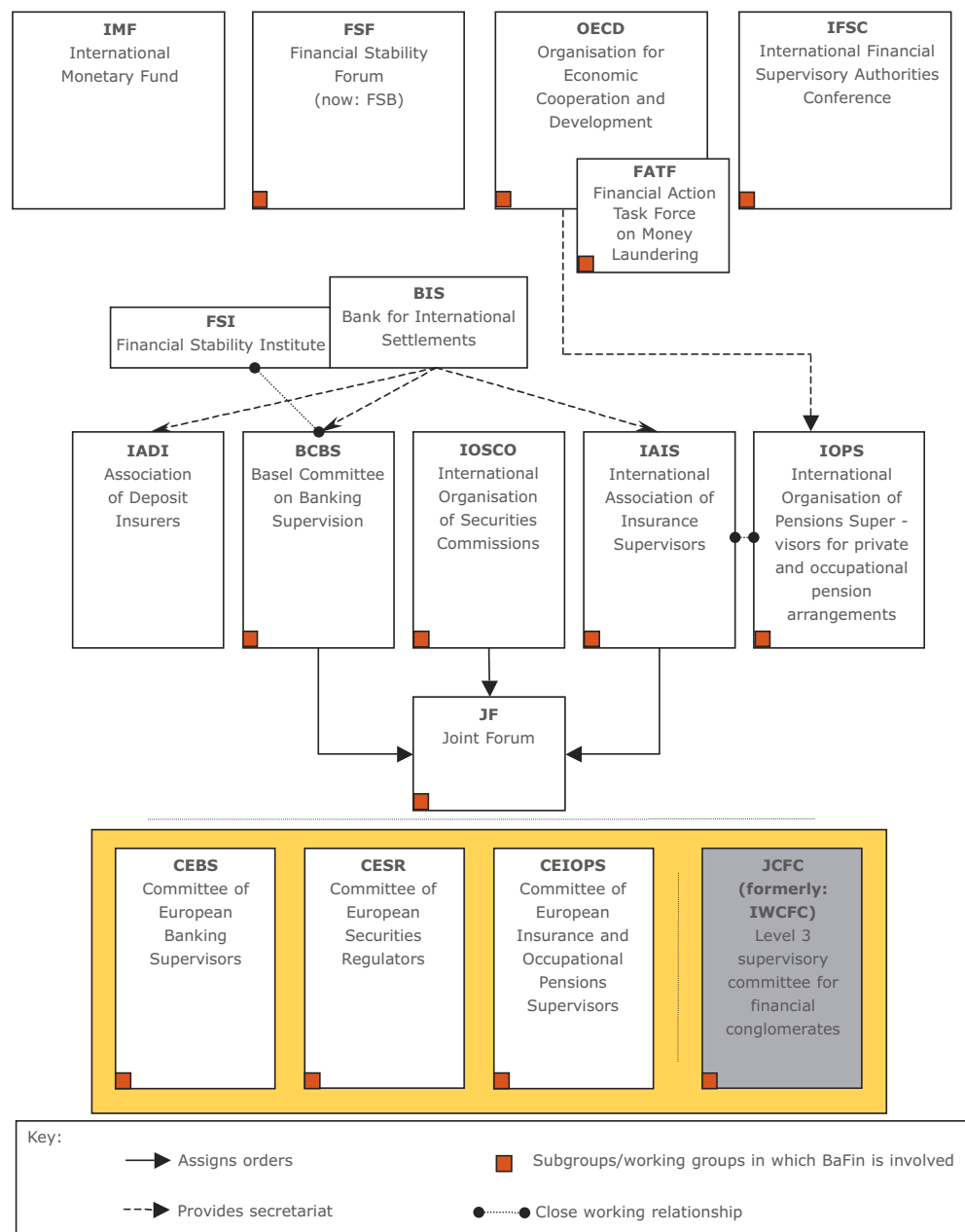
22) Following the implementation of Basel II in the KWG, or rather in the SolvV, on 1 January 2007, the solvency reporting system and therefore the calculation of the solvency ratio, was also revised.



# III International

## 1 International harmonisation

Figure 12  
International institutions and committees<sup>3</sup>



<sup>3</sup> The documents referred to in the text are located on the websites of the corresponding organisations (www.bafin.de » English version » BaFin » International cooperation).

### International priorities

The onset of the financial crisis and its subsequent worsening following the collapse of the US investment bank Lehman Brothers in mid-September defined the work of the supervisory bodies in Europe and worldwide in 2008. Prior to the failure of Lehman, the problems arose in the form of a slowly deepening sub-prime crisis; thereafter, the world teetered on the brink of a crisis which almost brought the global financial system to the point of collapse and forced governments and central banks to act. At the G7 summit in April 2008, the Financial Stability Forum (FSF) put forward 67 recommendations designed to strengthen prudential oversight of financial institutions' capital, liquidity and risk management, to enhance transparency and risk valuation, to bring about changes in the ratings process for structured financial products, to improve supervisors' sensitivity to risk and to make arrangements for dealing with stress situations on the financial markets. The newly established 'FSF Working Group on Market and Institutional Resilience' implemented the recommendations and also brought together further contributions, such as those of the standard setters in the sector, namely the Basel Committee, IOSCO and IAIS as well as those of the IMF and IASB. The FSF measures were to be implemented at national level in two stages, by the end of 2008. In Germany, the process was reviewed and followed up by BaFin, the Bundesbank and the Federal Ministry of Finance. At European level, this work accompanied that of the 3L3 committees, thereby making national implementation easier: CEBS (for banking supervision), CEIOPS (for insurance supervision) and CESR (for securities supervision). Other FSF working groups dealt with issues requiring medium-term solutions: the pro-cyclical effect of supervisory provisions, issues relating to valuation and value adjustment and to capital and remuneration. In the EU, the 3L3 bodies proved themselves to be a valuable network during this period, bringing about increased cooperation between national supervisory bodies in Europe and serving as an important centre for information after matters came to a head in mid-September.

At the global finance summit of the 20 most important industrialised nations and emerging markets held in Washington in November 2008, the heads of state and government of the G20 countries passed principles for reform. These included the closing of regulatory and supervisory loopholes at international level and ensuring that there are no relevant market participants, markets or products which remain unsupervised. In future, market participants must also be prevented from evading supervision by transferring their registered office to uncooperative, non-transparent jurisdictions which have failed to implement the internationally accepted supervisory standards. Overall, action is clearly required in the following areas: financial supervision, regulations, payment and incentive systems, risk management, valuation and transparency.

## 1.1 Financial stability and market transparency

### Financial stability

The **Financial Stability Forum** (FSF) is a global body comprising high-ranking representatives of ministries of finance, central banks and supervisory authorities from twelve countries as well as representatives of major financial institutions (e.g. IMF, World Bank, BIS, ECB). Based in Basel, the Forum was set up in 1999 on the back of the Asian crisis, amongst other things. The FSF discusses issues of fundamental systemic importance with regard to financial stability. These issues need not always directly concern supervision but may also impact on it only indirectly. In 2008, the financial market crisis was clearly the main priority in terms of the FSF's work. The G20 summit held in London in spring 2009 decided that the FSF should be enlarged, and re-established it as the Financial Stability Board (FSB).

Upon the initiative of the G7, the Financial Stability Forum analysed the causes of the financial crisis and identified any weaknesses. At the G7 summit in Washington in April 2008, an FSF working group submitted to the finance ministers and central bank governors of the G7 countries a report containing concrete recommendations for action to increase market discipline and strengthen financial markets. Accordingly, the working group's recommendations cover five areas:

- Strengthening prudential oversight of financial institutions' capital, liquidity and risk management
- Improving transparency and valuation of risks
- Changes in the ratings process for structured financial products
- Enhancing supervisors' sensitivity to risk
- Arrangements for dealing with stress situations on the financial markets.



Given the seriousness of the situation, these recommendations should be implemented as quickly as possible, some of them within 100 days or by the end of 2008. In October 2008, the FSF, which monitors the implementation of the recommendations, published a follow-up report on the progress made regarding the implementation in individual countries. All of the recommendations of the FSF were implemented on time. In Germany, many of the recommendations were already covered by the minimum requirements for risk management (MaRisk), which were published in October 2007. BaFin is incorporating the remaining sections into the minimum requirements, which are to be published during the first half of 2009.

Set up in 1945, the **International Monetary Fund (IMF)** is – like the World Bank – a special organisation of the United Nations. In keeping with the vision of its founders, the aim of the IMF is to secure the stability of the international monetary and financial system. Today, 184 countries are represented in the IMF.

The Financial Sector Assessment Program, based on which the IMF examines the level of risk inherent in the financial systems of individual countries, is of particular interest to BaFin. In this respect, special attention is paid to any early warning indicators and the quality of supervision of banks, insurers and the securities market.

● Global finance summit establishes principles for reform.

The summit participants decided on principles for reform and an action plan for implementation. The decisions also included a reform of the IMF and of the FSF. The FSF must accept more emerging markets as members and cooperate more fully with the IMF. The FSF and IMF should, together with other regulatory authorities and bodies, draw up recommendations to lessen the impact of negative economic trends and examine how valuation and external borrowing, bank capital, managerial salaries and bonus payments can intensify economic trends. Moreover, they are to increase their level of cooperation to bring regulatory and supervisory measures more into line with macroeconomic circumstances. In this respect, the IMF is to adopt a more prominent role as an adviser in issues regarding macro-financial policy.

Located at the Bank for International Settlements (BIS), the **Basel Committee on Banking Supervision (BCBS)** was established in 1974 by the central banks of the G10 nations. It represents the central banks and banking supervisory authorities from 13 countries. The Basel Committee formulates supervisory standards and recommendations for banking supervision (such as the Basel II regulatory capital standards) and also aims to improve cooperation between the responsible supervisory authorities at national level.

● BCBS continues to develop banking supervisory standards.

The Basel Committee for Banking Supervision regularly discusses the events of the crisis and the resulting steps which need to be taken to develop banking supervisory standards further. In January 2009, the Committee put forward proposals for consultation regarding the adjustment of the Basel framework and additional regulatory capital requirements for those financial instruments in the trading book exposed to a credit risk (Incremental Risk Charge). The FSF recommendations are of major importance for the Basel Committee's work programme which covers six key topics:





- Strengthening the regulatory capital adequacy requirement taking account of anti-cyclical components
- Rapid implementation of liquidity risk management requirements and clarification of outstanding issues regarding liquidity buffer
- Improving risk management
- Market transparency
- Supervisory cooperation for cross-border institutions
- Macroeconomic interdependencies between the banking sector and the real economy.

The Basel Committee also analysed the existing insolvency and settlement regulations of the Basel member countries. It found a lack of harmonisation regarding the regulations governing crisis management which makes them unsuitable for the successful management of systemic, cross-border banking crises. Since national law naturally stops at a country's borders, the problems of an increasingly integrated market are beyond its scope. Usually, the national legal framework is designed to guarantee financial stability. The framework's aim is to deal with individual legal entities. Although arrangements geared to national requirements and aimed at retaining assets domestically as far as possible may reduce the losses of creditors in the country concerned, from the perspective of the individual institutions and the international financial system, it does not provide an ideal solution to the crisis.

Created in 1983, the **International Organization of Securities Commissions (IOSCO)** is the most important international forum of securities supervisors. The Madrid-based body is the globally acknowledged standard-setter in the area of securities. The standards and resolutions adopted by IOSCO are observed in national regulations by the 181 members from over 100 countries.

● IOSCO places main emphasis on deficiencies.

In order to prepare for implementation of the FSF recommendations from April 2008, in May IOSCO passed the Report on the Subprime Crisis, which set out the Organization's initial work brought about by the crisis. The report deals primarily with the following areas:

- Transparency in issues, especially of structured products
- Due diligence requirements of institutional investors when acquiring complex financial products
- Risk management of institutional investors and regulatory capital requirements for institutional investors
- Accounting, in particular valuation of structured products in the crisis
- Role of ratings agencies

Work mandates relating to each of these areas were given to the responsible Standing Committees. A specific mandate is to be highlighted under which the principles regarding disclosure requirements for public offerings of asset backed securities are to be developed. Results are scheduled for June 2009. In May 2008, IOSCO also tightened its code of conduct for ratings agencies.

The global finance summit in November 2008 produced further immediate measures. A few days later, IOSCO set up three task forces. The first deals with different national restrictions and disclosure requirements worldwide relating to short-selling. Its objective is to harmonise the various regulatory approaches to short-selling at global level. The focus is on regulations designed to improve settlement discipline and transparency regulations with regard to short-selling. A second task force has the remit of detecting supervisory loopholes regarding unregulated financial products and markets and putting forward proposals for improvements. Here, the focus is primarily on structured products and credit default swaps which to date have largely been traded only on the OTC market. The third working group examines the potential for improving supervision of hedge funds, which to date have largely gone unregulated.

At European level, the supervisors work together in the three so-called Lamfalussy bodies. As an integrated financial supervisory authority, BaFin is represented in the **Committee of European Securities Regulators (CESR)**, the **Committee of European Banking Supervisors (CEBS)** as well as the **Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS)**. The oldest of the three bodies is the Paris-based Committee of European Securities Regulators (CESR), set up in June 2001. Based on this model, a Commission Decision passed in November 2003 created the London-based Committee of European Banking Supervisors (CEBS) and the Frankfurt-based counterpart for insurance supervision (CEIOPS). The three committees have a dual role: firstly, as part of the European legislative procedure, they advise the Commission, among others; secondly, they ensure that supervisory practice is harmonised on a pan-European basis for their respective area.

● CEBS as a central information platform.

During the financial crisis, CEBS acts as a central information platform for its members. With respect to the Icelandic crisis in particular, CEBS adopted a key role and organised regular telephone conferences with the Icelandic authorities and the relevant EU supervisory authorities. CEBS compared the rescue programmes which European countries had launched as a result of the global financial crisis. The committee's conclusion was that unilateral and uncoordinated measures taken by individual Member States - for example, guarantees for the entire banking sector - significantly distorted competition in the first instance. The situation was remedied as a result of an agreement reached by the

Member States in mid-October to take coordinated action. CEBS also believed that the European supervisors were sufficiently well integrated in terms of government measures.

● CESR sets up task force on short-selling.

CESR too responded rapidly to the financial crisis. The work of this body is dictated by the European Economic and Financial Affairs Council (Ecofin) which coordinates the implementation of the G20 action plan in Europe. In October 2008, CESR set up a task force on short-selling. The latter exchanges ideas on the respective short-selling regulations – in particular the emergency measures taken since September and their consequences – in the Member States with a view to finding opportunities for the coordination of strategies. At the end of 2008, CESR presented an initial analysis on temporary emergency regulations. Concrete regulatory proposals are to be devised by May 2009. CESR also reports to the EU Commission on the implications of the collapse of the US investment bank Lehman Brothers. The body initially set up an internal information platform to gain an overall picture of the Lehman companies' activities, for instance on the sale of Lehman products, the customer categories affected, complaints from investors and possible consequences for the settlement of securities and derivatives transactions. Furthermore, CESR discusses whether measures are required in the area of post-trade transparency for transactions in structured products, CDS and corporate bonds. In the fraud case involving US fund manager Bernard Madoff, CESR is coordinating the exchange of information between supervisory authorities in Europe.

● CEIOPS analyses implications for insurers.

A survey carried out by CEIOPS confirmed that the financial crisis had also spread to parts of the insurance sector, albeit to a lesser degree than was the case with the banking sector. US insurers in particular are affected. Amid persistently weak stock market trends, insurers had to make more and more write-downs in the course of the year, although some of these are likely to be cushioned by hedging measures. CEIOPS also found in 2008 that insurers had invested very little in structured products. The exposure of the European insurance industry to Lehman Brothers and AIG was also very limited and negligible as far as Bernard Madoff is concerned. With a Crisis Task Force having been established specifically for such surveys, CEIOPS is always able to report quickly on the situation of European insurers. Overall, most European insurers appear to be sufficiently solvent to withstand further shocks. Nevertheless, the negative performance of the economy as a whole represents a challenge.

Established in 1994, the **International Association of Insurance Supervisors (IAIS)** lays down the international standards for insurance supervision. The IAIS also promotes cooperation between supervisory authorities and provides staff training courses. IAIS membership is made up of insurance supervisory authorities from more than 130 countries. In addition, some 130 organisations, including many insurance industry associations, have observer status.

IAIS learns lessons from the financial crisis.

The IAIS is examining the lessons which the insurance industry can learn from the financial crisis. These lessons will be incorporated both in current and in future standards. At its Annual Conference 2008, the IAIS resolved to further highlight the issue of group supervision; supervisory colleges, in particular, constitute a key topic. Since cooperation and the exchange of information between supervisory bodies are of key significance, the implementation of the IAIS-MMoU also plays a vital role. The IAIS also analysed the recommendations of the FSF and G20 and is currently in the process of implementing them. Accordingly, in keeping with the FSF recommendations, the regulatory requirements for own funds for monoline insurers are to be improved and examined. One reason why most IAIS Member States do not have any regulations specifically governing monoline insurers is because they are based in very few of the countries surveyed. In those places where the majority of monoline insurers are based, the jurisdiction in question has begun to ensure that suitable regulatory requirements for own funds are in place. The FSF recommendations were also included in the revision of the IAIS core principles for insurance supervision, which got under way in 2007. The core principles have been in place since 2003; the IAIS intends to adopt the revised version in 2011. As part of its Financial Sector Assessment Program, the IMF checks whether insurance supervisory bodies are implementing the principles. Furthermore, since 2008, the IAIS has a group dedicated to the issue of governance and compliance at insurers. One of the group's aims – in cooperation with bodies such as the OECD and World Bank – is to develop a framework for corporate governance within the insurance industry, which will serve as an aid for insurance companies and their regulators.

### Comprehensive supervision

Improved cooperation between supervisors.

The financial market crisis has illustrated that international cooperation between can be improved further. The national supervisor has a particular problem identifying risks which are transferred abroad. During times of crisis, however, cooperation between two supervisory authorities, which to date has been governed by bilateral agreements, has proved to be inefficient. As a result, obliging supervisory authorities and central banks that are responsible for groups of institutions engaged in cross-border activities to cooperate within the EU is an issue under discussion. In this respect, the existing "colleges of supervisors" provide the institutional framework for this cooperation. In future, they are to carry out regular and full examinations of the business models of the groups of institutions, in order that the responsible supervisors can together get a full picture of all risks.

Cross-sector cooperation of the **Level 3 bodies**: 3L3 is the term used to describe the three European level 3 financial supervisory bodies (CESR, CEBS and CEIOPS). In order to ensure that European regulations are being applied and interpreted in the same way in each country, the 3L3 committees initially developed instruments largely independently of each another, and tested them in their respective area. However, over recent years, they have continually expanded their level of cooperation: in a Joint Protocol on Cooperation, CEBS, CESR and CEIOPS committed themselves to closely harmonise their work on all issues of common interest. This protocol was revised in 2008 in order to take account of the developments in the cooperation between the three committees.

Each year, the three bodies devise joint work programmes which they publish on their websites. This is the basis on which cooperation and a common strategic focus of CESR, CEBS and CEIOPS are to be expanded in future.

Continued development of the European supervisory structure.

In 2007, the EU Commission reviewed the four-level Lamfalussy process, which is designed to accelerate European financial market regulation and make it more effective. The assessment by the Inter Institutional Monitoring Group (IIMG), a group of high-level representatives from the financial industry, and by the EU Commission and Council was positive on the whole. As a result of the review, the decision was taken to strengthen the Lamfalussy process and to consolidate supervisory cooperation and convergence. In May of the year under review, the ECOFIN Council instructed the EU Commission to align the existing constituting decisions (constituent act) of the three L3 committees CEBS, CESR and CEIOPS, which was carried out with effect from 23 January 2009. One aim was to underline the role played by the L3 committees in promoting convergence of supervisory practice and cooperation between national supervisory authorities. Against this background, the committees were to be allocated particular duties in the context of the constituting decisions. The new constituting decisions include a non-exhaustive list of tasks and grant the three L3 committees a more important role in preserving financial stability than was previously the case. In order to improve the passing of resolutions within the committees, a qualified majority voting procedure has been introduced in the event that consensus cannot be reached, and this is based on the procedure for Council votes. Members who do not keep to the measures decided by the committees must disclose their reasons for so doing. In legal terms though, the measures taken continue to be non-binding.

● Joint 3L3 work and projects.

As the crisis has shown, the sub-areas of the financial industry are greatly dependent on one another. The financial industry not only constitutes a network at international level; domestically, too, banks, insurers, securities markets and financial services are highly interconnected across sectors. For this reason, CESR, CEBS and CEIOPS set up the Task Force on Cross-Sectoral Risks to Financial Stability in Europe. The main aim of this group is to identify early any threat of contagion with systemic implications as well as cross-sector risks to financial stability. At European level, the Task Force relies on the principle of integrated financial supervision.

Another joint project of the 3L3 committees was to devise a guidance paper for covering the procedure and valuation criteria in the event of an acquisition or an increase in a significant participation in credit institutions, investment companies or insurance and reinsurance companies. The guidance paper is designed to create cross-sector and common European understanding for the criteria which supervisory authorities must examine when a participation is acquired. In addition, it ensures the rapid exchange of information between supervisory authorities. It also contains an exhaustive and harmonised list of information which a potential acquirer must submit to the responsible supervisory authority in the event of an acquisition or an increase in a participation in the financial sector.

In January 2009, the EU Commission decided to set up a permanent joint financial conglomerate body at level 3. The new **Joint Committee on Financial Conglomerates (JFCF)** succeeds the **Interim Working Committee on Financial Conglomerates (IWCFC)** and replaces this interim structure. The JFCF is a joint committee of European banking and insurance supervisors. Through its work, it aims to support the consistent and full implementation of the Financial Conglomerates Directive in the individual Member States.

● Revision of the Financial Conglomerates Directive.

In 2008, the IWCFC, acting on behalf of the EU Commission, carried out a stocktake of the Financial Conglomerates Directive with regard to language, scope and internal controls requirements and analysed potential differences in the implementation of the Directive in individual Member States. In so doing, the main problem identified by the IWCFC was the application of thresholds for determining a financial conglomerate. In the interests of risk-oriented supervision, the body proposes to adjust the thresholds and to revise the possible ways in which a company may be exempt from additional supervision as a financial conglomerate. Besides the thresholds, defining the term participation also causes difficulties in practice. The definition is to be revised accordingly and its implications on additional supervision as a financial conglomerate are to be examined.

At the end of January 2009, the Commission asked the JCFC to provide not only an assessment of the situation but also to submit concrete proposals to amendments with respect to the revision of the Financial Conglomerates Directive.

● IAIS commitment to supervision of insurance companies on a group-wide basis.

In 2008, the IAIS formulated principles regarding the supervision of insurance companies on a group-wide basis. Complementing to the supervision of individual companies, these principles establish fundamental framework conditions for internationally acknowledged group-wide supervision. The aim of the principles is to contribute to ensuring appropriate streamlining, consistency, efficiency and effectiveness of supervision on a group-wide basis. This is to be achieved in particular by means of regulations on the group-wide capital situation, governance, risk management as well as the exchange of information and cooperation between supervisory authorities. Particular significance is attributed to the group-wide supervisor. As a rule, the insurance supervisor is the one in whose jurisdiction the insurance group has its registered office. However, other criteria may also be decisive in determining the choice of group-wide supervisor, such as the level of business turnover for instance. The IAIS has detailed the potential criteria for selecting the group-wide supervisor and set out the supervisor's duties in a guidance paper. As a result, the issue of group-wide supervision at international level has taken a major step forward in the year under review, and further progress is afoot. For instance, in an issues paper adopted in March 2009, one of the topics addressed by the IAIS was that of group-wide solvency assessment. However, no recommendations have been made as yet.

The corresponding IAIS body, which BaFin has chaired since October 2008, also worked on recommendations for cooperation in supervisory colleges, which will further enhance international group-wide supervision in 2009.

### **Market transparency**

● IOSCO revises its code of conduct for rating agencies.

At the end of May, IOSCO presented a revised Code of Conduct Fundamentals. In its Report on Enhancing Market and Institutional Resilience in April, the demand previously made by the FSF was to ensure, as quickly as possible, that the confidence of all market participants in the quality, consistency and integrity of the ratings is restored. Under the revised, still non-binding Code of Conduct, rating agencies must in future provide information regarding structured financial products which investors can use to help them form a detailed opinion about a rating. They must publish the methods employed to categorise structured financial products and provide general access to the rating methodology which they use. IOSCO has also tightened up its demands as far as independence and conflicts of interest are concerned. The aim of the IOSCO code, which has been in place since the end of 2004, is to protect investors and enhance market efficiency by means of more transparent, higher quality ratings procedures devised with integrity. Although the code is not legally binding, agencies must

- EU Regulation on governing rating agencies.

nevertheless adopt its requirements in their internal codes of conduct and disclose any deviations from the code.

In mid-November, the EU Commission put forward a draft Regulation on governing rating agencies. While its contents are based on the IOSCO code, it also introduced some of its own requirements. A registration requirement is introduced for rating agencies which issue ratings for regulatory purposes. CESR is to develop guidelines for the registration and supervision of rating agencies so that the same criteria are applied throughout Europe.

- IOSCO focuses on transparency of structured financial products.

The financial crisis saw IOSCO address the issue of transparency requirements in the trading of structured products. Including the involvement of market participants, what is being investigated on the one hand is the issue of whether trading in structured products is sufficiently transparent. The focal point of the investigation is post-trade transparency. On the other hand, IOSCO consulted on guidelines regarding disclosure for asset backed securities (ABS) which are publicly offered or admitted to trading on a regulated market, and looked into the issue of the information available to institutional investors being offered ABS. Institutional investors do not normally receive a prospectus and are therefore reliant on information from other sources. The results of this work are to be published by mid-2009.

- CESR consultation paper on post-trade transparency.

At the end of 2008, CESR published a consultation paper on post-trade transparency on the market for corporate bonds, structured financial instruments and credit default swaps (CDS). In this paper, CESR also reviewed its conclusions on a report on trade transparency in the bond market from summer 2007. The Committee took the view that insufficient post-trade transparency was not the cause of the current problems of these trading segments and that additional post-trade transparency alone will not solve these problems. However, CESR believes that a greater level of post-trade transparency, especially in the bond market, would be beneficial for market participants. The consultation is designed to illustrate whether and to what extent greater post-trade transparency could benefit price formation and valuation methods in the individual market segments. In preparing this consultation paper, CESR analysed the experiences of the US TRACE system for OTC post-trade transparency in the corporate bond market, examined the self-regulation initiatives of the financial industry with a view to increasing trade transparency and surveyed market experts.





- CESR and ERGEG recommendations on the regulation of the electricity and gas market.

The EU Commission has issued a joint mandate to CESR and ERGEG (Energy Regulators' Group for Electricity and Gas) to address a number of issues regarding the future regulation of the electricity and gas market. To prevent market abuse in future, the bodies are advocating the creation of a tailored abuse framework for the sector, including a prohibition on insider trading and market manipulation under energy law for all of the products not covered by the Market Abuse Directive. The proposal applies to spot and derivative transactions relating to electricity and gas, irrespective where they are traded. CESR and ERGEG also recommend imposing an obligation on experts in this field to publish data which are relevant for the electricity and gas market – for instance, a loss of generation or transportation capacity – in an accurate and legally-binding manner at a central office. Furthermore, they recommend a harmonised post-trade transparency scheme. Under this scheme, in the electricity and gas market, all EU trading platforms – including broker platforms – are to publish harmonised data on spot and derivative transactions which are traded or cleared thereon. ERGEG also recommends that daily-aggregated trading data be published by these platforms. A minimum contents list for the recording of spot and derivative transactions is designed to create legal certainty. Upon the request of supervisors, the companies covered by the energy and gas directives will then be able to extract the relevant data from these records and forward them electronically within a suitable time frame. The creation of a solid legal basis in order to facilitate the individual exchange of information between financial and energy supervisors is also advisable, as a means of ensuring an appropriate level of market supervision.

- Aids for guidance on the Market Abuse Directive.

In May and October 2008, CESR produced draft copies of practical aids for guidance on and interpretation of the Market Abuse Directive, for public consultation. These are designed to provide market participants with a broad outline of the Directive's various aspects. The drafts cover the issues of insider lists and notification of suspicious transactions as well as stabilisation and share buy-back programmes and the assessment of rumours in terms of insider information. Following completion of the consultation and a public hearing, final publication is scheduled for the first half of 2009. The interpretation aids consulted last year are part of the third set of guidance on the operation of the Market Abuse Directive. The third set was prepared by CESR in response to a desire expressed by the market for further guidance following the first two sets.

- IOSCO examines outsourcing at stock markets.

The IOSCO committee for secondary markets, which is chaired by BaFin, prepared a consultation report on outsourcing at stock markets. The report provides an overview of international outsourcing provisions for stock markets and contains principles and recommendations for use.

- IOSCO examination of supervisory practices at intermediaries.

In 2008, IOSCO completed a final report on supervising compliance with codes of conduct for intermediaries. The responsible IOSCO committee established that audit practice – especially the frequency of audits – differed greatly between countries. However,

one feature common to all countries is the risk-oriented approach. In connection with the financial market crisis, the committee also began examining the liquidity risk management systems and internal control systems of a number of different institutions.

### Prospectus legislation

● CESR: Joint positions and statistics on EU on prospectus legislation.

CESR updated the catalogue of joint positions for the uniform application of prospectus legislation in 2008. The last time the catalogue was updated, in February 2009, 71 joint positions were published on frequently asked questions with regard to prospectus legislation. On behalf of the European Commission, every six months the expert group also gathers statistical data from all European Member States on prospectuses for which verification or notification has been provided.

● Review of Prospectus Directive started.

Five years after the Prospectus Directive came into force, the European Commission started to carry out a review of its application. Accordingly, it submitted a report containing proposed amendments to the European Parliament and the Council. The expert group for prospectuses will comment on the report as part of the consultation process.

● New UCITS Directive covers the cross-border set-up of funds.

### Investment funds

In October 2008, CESR declared itself in favour of a cross-border set-up of funds and formulated requirements relating to the new regulations. Given that its proposal for a revision of the UCITS Directive did not contain any provision allowing for the cross-border set-up of funds, CESR was requested by the EU Commission to make its recommendation. The redrafted UCITS Directive will make it possible to set up funds on a cross-border basis and simplify the cross-border notification procedure whilst also containing provisions for master-feeder structures and cross-border fund mergers. Adoption by the European Council is pending.

● Commission consumer tests on "Document with important information".

In the year under review, the EU Commission carried out tests to find out whether private investors correctly understand information regarding the concept of a simplified sales prospectus. The test results should be available in May 2009. CESR had earlier revised the concept of the simplified prospectus and summarised the result of this work in a recommendation to the EU Commission. The document aims to highlight the essential information for the investment decision in a simplified manner.

● IOSCO report on funds of hedge funds.

In June 2008, the IOSCO Technical Committee published a report on funds of hedge funds in various IOSCO Member States and gave market participants the opportunity to comment on the best market practices devised with the help of industry representatives. The standards include information both on how fund of hedge fund managers should deal with liquidity risks and on the due diligence process used in connection with target funds. 2008 also saw IOSCO publish a summary of supervisory rules for real estate funds and REITS in various IOSCO Member States.

## 1.2 Risk management and own funds

### Regulatory capital

● Adaptation of the Basel standards.

The sub-prime crisis has shown that the quality of risk management is of great importance in terms of the fate of banks during times of crisis. Based on the findings of the FSF, the requirements of the Basel II Accord need to be strengthened if financial markets are to be made more resistant in the long term to crisis situations, especially since the latter has thus far corrected only the most serious shortcomings in the old regulatory structures under Basel I. What is planned in particular is an increase in the level of regulatory capital based on additional rules, to ensure that banks retain a more substantial capital buffer for times of crisis. However, given the time pressure and the current state of the financial markets, only the obvious problems will be tackled for now, but further reforms can be expected in the medium term. In addition to the Basel regulations, other standards with a bearing on the financial markets are also to be adapted, such as the consolidation rules for instance. Consequently, it must no longer be possible in future to transfer high-risk assets into supposedly orphaned special purpose vehicles (SPVs) without attributing these SPVs to the beneficiaries. This was precisely what occurred in the past, however, for vehicles with sub-prime assets running into the billions. In order to prevent this from happening in future, the FSF recommends that the consolidation rules be redrafted accordingly.

● Work on the "Definition of capital".

The BCBS intends to continue the work on the issue of the definition of capital, with priority being given to improving the quality of tier 1 capital. This must continue to comprise conventional and hybrid capital instruments. A uniform understanding of the term traditional core capital instruments must first be developed. Based on this, the working group must then draw up fundamental principles for regulatory capital. In line with what the CEBS has already done at European level, key points should be developed for the supervisory assessment of the recognisability of core capital instruments. The extent to which a core capital instrument is able to absorb losses deserves particular attention here.

Located at the Bank for International Settlements (BIS), the **Basel Committee on Banking Supervision** (BCBS) was established in 1974 by the central banks of the G10 nations. It represents the central banks and banking supervisory authorities from 13 countries. The Basel Committee formulates supervisory standards and recommendations for banking supervision (such as the Basel II regulatory capital standards) and also aims to improve cooperation between the responsible supervisory authorities at national level.

- Additional regulatory capital provision for trading book positions entailing a credit risk.

One key reform by the Basel Committee in the year under review was the incremental risk charge (IRC), an additional regulatory capital requirement for those financial instruments in the trading book entailing a credit risk, such as corporate bonds and credit derivatives. The IRC extends the scope of the risks to be included, going beyond what are pure default risks. The background to the additional regulatory capital requirement is the structural change in the trading books of many credit institutions towards financial instruments entailing a credit risk. Moreover, credit institutions increasingly assigned less liquid instruments to trading books, such as complex derivatives or loans, in order to parcel them up for securitisation. The increasing illiquidity produced a strained relationship to the previous Basel standards for market risk which take as their starting point the option of being able to realise or hedge financial instruments at short notice. One key feature of the IRC is that the regulatory capital requirement for illiquid products tends to be greater. At the same time, with the IRC the Basel Committee is pursuing the strategic aim of achieving a degree of convergence in terms of the supervisory "safety standards" between the trading book and banking book in respect of the amount of the regulatory capital requirement.

- EU Commission revises Banking Directive.

The EU Commission wants to transpose the 1998 Basel Accord relating to hybrid capital – which combines the features of both own funds and liabilities – into European law and has therefore proposed revising the Banking Directive. The Basel Accord was previously the only requirement at G10 level for the recognition in banking supervision terms of hybrid financial instruments in regulatory core capital. Nevertheless, the EU Commission has established that there are considerable differences in the recognition of hybrid capital as an element of core capital in individual Member States due to the fact that there is no standard EU-wide regulation to this end. The differences are primarily in two areas: the requirements for the recognition of hybrid financial instruments as regulatory own funds and quantitative ceilings for recognition as core capital. The Commission proposal is designed to improve the quality of regulatory capital. It counters the differences which have been found by putting forward an EU-wide standard interpretation of the three main regulatory capital criteria – durability, loss participation and full decision-making authority of the institution with regard to distributions. As a result, there are clear criteria in place as to whether hybrid financial instruments may be added to a bank's overall capital. It is also introducing harmonised quantitative ceilings for the recognition of those hybrid financial instruments for which there is, under certain circumstances, a contractual provision for conversion into conventional core capital instruments – typically stocks. Finally, the Commission proposal contains a comprehensive grandfather clause relating to existing issues so as to prevent any sustained disruption to the financial market. The eligibility of transactions which do not meet the new requirements, remains virtually unchanged during the first ten years after the new regulations have come into force.

● New standards for liquidity management.

## Liquidity

As a result of the financial crisis, liquidity risk management played a major role in 2008. In terms of liquidity, credit institutions were only prepared to deal with shocks affecting one institution or a group of institutions. Furthermore, banks and supervisors did not rate liquidity risk as a primary risk. Hitherto, each liquidity squeeze tended to be caused by types of risk with inadequate cover or none at all. Following the events of 2007 and 2008, these basic assumptions are no longer valid. The Basel Committee and CEBS worked in parallel to analyse the causes and provide initial responses from a supervisory perspective. The primary requirement of both committees is a suitable liquidity buffer. This should be made up of assets which can be turned into liquid resources at any time and should last for a period of time which is commensurate with an institution's business activity. In accordance with the requirements of the Basel Committee, a market-wide liquidity shortage – constituting as it does both a scenario of threatened stability and a primary risk – is a factor that must be included in institutions' overall risk management as well as in the overall consideration with respect to supervision. A number of additional requirements are being formulated in the Basel principles and the CEBS recommendations. Both committees are demanding emergency liquidity plans containing responsibilities and escalation procedures. It was also decided that liquidity risk management is the responsibility for the entire executive board. In addition, the committees are demanding the introduction of particular rules for measuring and assessing liquidity risks: based on limit systems, the institutions must be able to identify bottlenecks at an early stage and deal with them by means of their strategic safety nets. Both bodies also want to restructure the incentive systems covering the taking of liquidity risks. For instance, in future institutions should still be able to plan, obtain and distribute liquidity centrally although the costs of doing so should no longer be incurred only by the responsible body. The demands by the committees in respect of future disclosure rules are a contentious issue between supervisors and institutions. Maintaining a balance between the required level of market transparency on the one hand and the sensitivity in particular of liquidity data on the other represents a major challenge for markets and supervisory authorities.



Germany will rapidly implement the Basel principles. In particular, this requires a revision of the MaRisk with regard to risk management and controlling processes for liquidity risks. The Basel principles are also reflected in the changes made to the EU Banking Directive in terms of liquidity risk management. The extent and structure of the liquidity buffer is to be specified by mid-2009.

- IAIS working on international solvency standards.

In the year under review, the IAIS published standards and guidance papers on regulatory capital requirements, corporate risk management and the use of internal models to determine solvency capital. These three areas are part of an international framework which IAIS is developing on the solvency supervision of insurance undertakings. In keeping with the fundamental principles of the European Solvency II project on the modernisation of insurance supervision, the insurance supervisors in the IAIS have agreed on an economic and risk-oriented approach to solvency supervision. This is designed to improve corporate risk management and harmonise regulatory requirements and corporate practice. Further standards and guidance papers on determining own-fund adequacy, assessing the solvency of assets and actuarial reserves as well as on the asset liability management of insurance companies are to follow in 2009. Finally, an overarching solvency standard should explain the interplay between the individual sub-modules and tackle the overriding considerations underpinning solvency supervision, such as the application of the principle of proportionality.

- Convergence in the implementation of the second pillar of Basel II.

CEBS has begun to compare the various different national supervisory approaches and risk identification systems. The requirements of the European Directive provide Member States with a great deal of scope in terms of the structure of the second pillar of Basel II. The fact that this has resulted in very different approaches is largely due to different financial market structures, but also to different supervisory cultures. The primary aim of CEBS is to promote intra-EU convergence in the implementation of the second pillar of Basel II so that banks with similar risk profiles within the EU can be dealt with in a similar way. A focal point of the work is the institutions' capital adequacy requirements. In the year under review, CEBS also published a consultation paper aimed primarily at supervisors which deals with the supervisory assessment of diversification effects in institutions' internal models. The paper covers a range of issues, for instance on the empirical basis of the diversification assumptions for institutions together with the analysis of these assumptions based on stress tests. Supervisors can discuss the issues with the institutions as part of supervisory talks.

- IOPS discusses impact of financial crisis.

### 1.3 Occupational pension schemes

Just as for the other international organisations, the financial market crisis has also been the key issue for the International Organisation of Pension Supervisors (IOPS), the counterpart to the IAIS for the field of occupational pension schemes, over recent months. These schemes, too, had to make write-downs on some of their investments. The first consequence of the crisis was an intensification in the dialogue between IOPS members and the industry. The IOPS members are also working on the issue of procyclicality and studying macroeconomic developments.

IOPS: Guidelines on the supervision of occupational pension schemes.

IOPS approved guidelines for the ongoing supervision of occupational pension schemes in October 2008. The corresponding working paper deals with the fundamental requirements and special features regarding the provision of information and the inspection of the financial position as well as the corporate governance and the investment strategy of the schemes. By means of regular inspections and with the help of defined monitoring and control mechanisms, the data and information submitted are to be validated and compiled. The aim is to be able to assess the scheme's general position and its financial strength. From this, the supervisor can derive a risk profile, which will permit him to obtain a better understanding of the scheme's individual circumstances and assess possible future trends. The supervisors have committed themselves to exchanging pertinent information with one another in compliance with confidentiality obligations.

#### **Supervision of corporate governance in occupational pension schemes**

Most countries have rules governing the way in which corporate governance in multi-purpose companies is to be supervised. In certain countries, these rules can also be applied to corporate governance in occupational pension schemes. It is often necessary, however, to introduce additional or different requirements, as aspects of corporate concepts can differ fundamentally. Generally applicable rules for corporate governance are geared primarily towards the interests of partners and shareholders, whereas the rules for corporate governance in occupational pension schemes are focused on protecting beneficiaries. For this reason, the protection of beneficiaries' interests and the safeguarding of the financial stability of the scheme and of the entire financial system form part of the supervisor's objectives at all times.

OECD and IOPS organised a collective survey of supervisory authorities to identify the current main focal points in the supervision of corporate governance in occupational pension schemes together with future trends. The results of the survey stress the particular importance of good corporate governance, which depends above all on the expertise and specialist knowledge of managers and decision-makers. The focus here is also on the special responsibility held by members of the board and on the importance of adequate internal control mechanisms.

CEIOPS presents report on outsourcing.

CEIOPS published a report on outsourcing in October 2008. The report deals with the rules and practices in the EU and EEA which are applied when services and functions are outsourced by occupational pension schemes. The aim is to promote a common understanding of outsourcing within the EU and EEA. The report reveals significant differences between the EU Member States and the EEA signatory countries. For example, occupational pension schemes in some countries are permitted to outsource many functions and services, whereas other countries place clear limits

on this. Moreover, in some countries the outsourcing of particular functions and services is either compulsory or, alternatively, these may only be performed by specific service providers. Variations also exist in terms of the obligations which occupational pension schemes and service providers must fulfil in the outsourcing process. In every EU Member State and EEA signatory country, however, the relevant occupational pension scheme itself bears responsibility for the outsourced functions and services.

● Cross-border occupational pension schemes.

In 2008 CEIOPS reported on the development of cross-border activities by occupational pension schemes within the EU and the EEA. The report states that, between January 2007 and June 2008, the number of schemes with cross-border activities rose by 22 to a total of 70, distributed across nine home and 21 host Member States. This corresponds to an increase of approximately 46% inside 18 months. When comparing individual cases, it is important to bear in mind, however, that the EU Member States and the EEA signatory countries define cross-border activities in a different way. In the future, CEIOPS will update the report annually to give market participants an overview of developments in this field.

## 2 Amendment to the Capital Adequacy Directive

● European Commission seeks to revise the CRD for 2009.

With effect from 1 January 2008, the Capital Requirements Directive (CRD), which consists of the revised Banking Directive and the revised Capital Adequacy Directive, has been transposed into national law in all EU Member States and made binding. Nevertheless, the European Commission is already proposing to amend the CRD in 2009. To this end, it presented various proposals for the amendment of the Banking and Capital Adequacy Directives in 2008. According to current plans, the Member States are expected to transpose the amended CRD into national law by the end of 2010. Further proposed amendments can be expected in 2009, particularly regarding the implementation of the enhancement to Basel II, on which the Basel Committee for Banking Supervision has already started work.

● Need for amendments.

Initially, the proposed amendments were intended to eliminate ambiguities and discrepancies that had become apparent during the implementation of the EU Directives or the application of national laws ("technical changes"). The amendments were also intended to reduce the number of national discretions in the Directives. A further objective was added in the wake of the financial market crisis: it was now also a matter of eliminating weaknesses in the CRD which only came to light during the crisis. This concerns, for example, changes to the set of securitisation regulations and the specific market risk, particularly with regard to the incremental risk charge, which is already applied in the Basel regulations. Also affected are rules for crisis management and European cooperation in group supervision.



### Regulatory capital requirements (Pillar 1)

The first Basel Pillar – which is concerned with minimum regulatory capital requirements – is intended to tighten regulations on resecuritisations. Additional requirements are made of institutions which use internal market risk models for interest rate risks of the trading book, specifically using the incremental risk charge for largely illiquid trading book items and the “migration” of ratings. In addition, the capital requirements for short-term liquidity facilities for securitisation transactions are to be raised to the same level as for longer-term lines of the same type. The final item on the agenda is the formalisation of principles and rules, deliberately postponed in the original CRD, according to which hybrid capital instruments can be considered as part of the regulatory core capital.

#### Excess for securitisations

In the area of securitisation, it was initially provided for that the so-called originators, who constitute the claims to be securitised through the granting of loans or through the purchase of existing claims, should retain regulatory capital for at least 15% of the securitised items. In the case of the direct sale of claims from non-banks to a special purpose vehicle (SPV), the same should apply to sponsors who place the bonds from the SPVs on the market, irrespective of the number of bonds that they retain. However, due to the competitive disadvantages for European banks arising from this, this proposal came in for a great deal of criticism.

The new proposal, drafted following this criticism, now focuses on investors, prohibiting them from investing in structures in which the originator or sponsor, based on his investments, does not have an economic interest of at least 5% in the securitisation portfolio in the long term. This is consistent to the extent that only the investor approach can also cover securitisations from the US market. Alongside exemptions for asset securitisations which are guaranteed by central banks and other institutions rated as secure, the new proposal also includes detailed specifications for investors’ risk management with regard to their securitisation items. Moreover, the current draft provides for disclosure requirements: for sponsors and originators on the one hand and for supervisory authorities on the other.

### Supervisory review process (Pillar 2)

The content of the second Basel Pillar, which is dedicated to the supervisory review process, will likewise change. Thus institutions are to develop their risk assessment and risk management procedures on a company-wide basis in future, for example to take account of off-balance-sheet and securitised products and to examine critically the valuation of all the institution's own products. In addition, they are to use stress testing to check whether their risk management procedures cover all pertinent risks.



New requirements are also being drawn up for liquidity risk management, an area which has hitherto not been uniformly regulated at international level. The Principles for Sound Liquidity Risk Management and Supervision, newly developed by the Basel Committee, require the banks to implement an improved system for the management of liquidity risk, stress testing and contingency funding plans and to retain a liquidity buffer. The latter must be large enough to provide a bank with a survival period in times of crisis. This is based on the assumption that banks will in future no longer be able to rely on liquid markets at all times, a fact which must also be taken into account in regulatory and supervisory practice.

### Disclosure requirements (Pillar 3)

The specifications of the third Basel Pillar – which is concerned with the issue of disclosure – are likewise to be tightened. As a result, banks will have to comply with detailed requirements when making disclosures, in particular with regard to securitisations in the trading book and the status of sponsors for structured investment vehicles (SIVs). In future, they will also have to describe the valuation method used for securitised products in the trading book (Internal Assessment Approach) in the same way as for the valuation principles in the case of securitised products. Banks will also have to disclose so-called pipeline and warehousing risks associated with these products, for example the risk that it becomes impossible to pass on a bank's asset-backed papers in the wake of a sudden market reversal.

### Large exposure regime

When the CRD was introduced in 2006, it had been decided not to undertake any radical revision of the current large exposure regime, but simply to adapt it to the new regulatory environment of the CRD as a first step. Nevertheless, the intention had always been to revise these regulations at a later stage. Thus the revised CRD is now designed to focus the large exposure regime more consistently on its objective than is currently the case, i.e. to limit individual counterparty risks regardless of the probability of their

occurrence in order to ensure a level of protection beyond the portfolio-based calculation of risk-bearing capacity (limit-based backstop regime). These measures are intended to simplify the regulations and thus make them more user-friendly.

First and foremost, they include the abolition of the 800% limit for the aggregate of large exposures and the 20% limit for non-consolidated affiliates. The extensive abolition of the "assignment of 0% risk weight" in terms of interbank lending is also particularly onerous. It is to be replaced by an allowance, up to which each institution may lend to other institutions irrespective of size. The current differentiation between varying conversion factors for off-balance-sheet transactions, e.g. for loan approvals with an original term of less than one year that have not yet been taken up, is also to be abolished.

For items whose risk is dependent on their underlying assets – e.g. fund and securitisation items – the decision should be made, in consideration of risk factors and on a case-by-case basis, whether a review must be carried out, either in addition to or in place of the simple approach, or whether it may be possible to omit it altogether. Furthermore, the regulation on the formation of borrower units in the case of economic interconnectedness is to be supplemented by the indication that potential mutual refinancing difficulties may also lead to the formation of a borrower unit. There are also plans to simplify the reporting regulations for large exposures and to standardise them at the same time. In respect of all three abovementioned points, there are plans for guidelines to be drawn up by a CEBS working group established specifically for this purpose.

### **Technical changes**

The predominantly "technical changes" to the Banking and Capital Adequacy Directives affect in particular the treatment of investment units at institutions which apply an Internal Ratings Based Approach (IRBA) and the recognition of the surrender value of life insurance as a hedging instrument. In Germany, these changes are to be implemented in the Solvency Ordinance.

### **Investment units at IRBA institutions**

First and foremost, changes in the field of investment units affect the calculation of the risk weightings for transactions which form the basis for an investment unit and which do not constitute investment items, and for which an IRBA institution cannot calculate the risk weightings according to the IRBA. For this case group, it is unavoidable that the risk weightings be calculated by recourse to the Credit Risk Standardised Approach (CRSA). With respect to incentive and prudence considerations, the risk weightings for risk items held via investment units must, however, be higher than for risk items which an institution holds and manages directly. The revision consists in bringing the risk weightings applicable to IRBA institutions closer to the CRSA risk

weightings insofar as the risk can be considered as moderate in light of external credit rating assessments. For risk items at the poorest rating level which form the basis of an investment unit, as well as for risk items for which the risk weighting cannot be derived from an external rating and which might therefore harbour high-risk items, the CRSA risk weighting is now to be increased to double the CRSA risk weighting for risk items held by the institution itself. A more appropriate risk weighting compared to the existing rules is therefore to be achieved for the risk items concerned. At the same time, the incentives to review an investment fund are maintained alongside the risk-sensitivity of the risk weightings to be applied. This also closes a loophole in the Directive in this regard. It existed for transactions forming the basis of an investment unit for which the CRSA risk weighting could not be calculated via direct allocation to a credit rating level. In its implementation in Germany, this loophole affected in particular claims on institutions, as in this case the CRSA risk weighting is dependent on the credit rating level of the central government of the country where the institution is domiciled.

#### **Surrender values of life insurance**

A further fundamental change for the German banking and insurance industries concerns the recognition of the surrender value of life insurance as a hedging instrument. In the future, it is no longer to be restricted to cases in which the life insurer has received a good rating from a ratings agency (CRSA) or a good internal rating (IRBA). The proposed change makes allowances for the fact that only a few life insurance undertakings have an external rating.

## **3 Solvency II**

● European Commission publishes proposed draft Directive.

In February 2008, the EU Commission published an amended proposal for the Solvency II Directive. The amended proposal now takes account of and integrates all 14 existing Directives from the areas of life and non-life insurance, reinsurance, insurance groups and liquidation. The Commission had published the original draft Directive in mid-2007.

● Draft triggers discussions in Parliament and Council.

The new proposed Directive sparked intensive discussions in the European Parliament and the European Council. As early as 2007, it had become apparent that the subject of group supervision was in need of revision. In its revised form, the proposed Directive now includes the option of a group support regime, in which a proportion of the subsidiary's own funds can be replaced with a guarantee commitment from the parent undertaking - an addition which triggered intensive discussions between Parliament and Council. No agreement was reached in 2008.

Parliament and Council also differed in their views on another subject, the assessment of the capital requirements for the equity risk. Intensive talks took place between Parliament, Council and Commission on this issue.

### Implementing measures

● CEIOPS submits initial proposals for implementing measures.

The Solvency II Directive will empower the European Commission to enact implementing measures. These are intended to define the Directive more precisely in order to harmonise and standardise supervisory procedures in Europe to a greater extent. The schedule provides for the Commission to have laid the foundations for discussions on the implementing measures by 2010. The Commission gave CEIOPS the mandate to draft proposals for the implementing measures in 2008 and 2009.

In May 2008, CEIOPS forwarded to the Commission its initial comments on the issue of proportionality and its first proposals concerning group supervision. Its thinking regarding proportionality was primarily concerned with the impact of the principle of proportionality in the three pillars as well as in internal models and in group supervision.

For group supervision, CEIOPS commented on issues relating to the group support regime. It highlighted the links between the group support regime and diversification effects and discussed specific questions relating to legal conditions and to the design of a group-wide risk management system, cooperation between supervisors and the corresponding publication requirements made of insurers.

● CEIOPS sets up four working groups.

The Commission expects to receive further proposals on the implementing measures in autumn 2009. For this reason, CEIOPS began its preparatory work in 2008 and established four working groups.

The Financial Requirements Expert Group (FinReq) deals with four main issues: actuarial reserves, own funds, the solvency capital requirement (SCR) and the minimum capital requirement (MCR).

With regard to the actuarial reserves, the working group discussed the possible actuarial methods, statistical techniques and assumptions available for the calculation of the best estimate and the risk margin. The group also established conditions for the use of proxies. Proxies are highly simplified calculation methods which offset incomplete claims data with general assumptions concerning future claims events. They are only admissible if they are compatible with the overriding principles of risk-based, market-consistent valuation. The resulting valuation must take account of the scope and complexity of the underlying risks.

In its work on own funds, FinReq compiled a list of equity capital instruments and divided them into three quality classes. The allocation of own funds depends on the extent to which the

instruments meet the following five key criteria: subordination; capacity to offset losses in ongoing operations; durability; low operating costs; and a low level of other charges. For the SCR, the findings from the four previous impact studies have been used to further develop the design of the modules and the correlation assumptions. Furthermore, FinReq specified which of the parameters used in calculating the SCR might be replaced by company-specific parameters.



The second working group, the Internal Governance, Supervisory Review and Reporting Expert Group (IGSRR), dealt with the following issues: reporting to the supervisory authorities; transparency and public accountability; disclosure requirements; conditions for establishing capital add-ons; requirements in terms of company management, valuation of assets and liabilities and admission conditions for special purpose vehicles. It will present its proposals on these issues to the Commission in autumn 2009.

The Internal Model Expert Group (IntMod) has devised detailed plans for the approval of full and partial internal models, in particular the requirements for the use test and the statistical quality test as well as the definition of quality and documentation standards. Its work will also take account of the results from the survey of undertakings on current industry practice carried out in 2008.

The Insurance Groups Supervision Committee (IGSC) is the fourth CEIOPS working group to formulate proposals for the implementing measures. It dealt with the following: details of group solvency, including with regard to parent undertakings or subsidiaries in non-Member States; cooperation, coordination and the exchange of information between the supervisors of a group; the reporting of risk concentrations and intra-group transactions; and the option for supervisory measures at group level.

● Impact of the financial crisis on the implementing measures.

In the wake of the financial crisis, CEIOPS presented a report on the valuation of illiquid assets to the Commission in August 2008. In November 2008, CEIOPS also completed a review of the risk management standards for assets applicable under Solvency I and those envisaged for Solvency II. In a further report on the findings from the crisis, CEIOPS will state whether discussions on the proposals for the implementing measures need to focus even more intensively on particular issues than is currently the case. A key question in this respect is how the capacity of different elements of own funds to absorb losses as well as the liquidity and market risks, including the risks in terms of contamination and reputation, can be reflected at company management level. Particularly with respect to the internal models, in which undertakings are granted considerable freedom regarding the individual calculation of their solvency capital, it must be ensured that the responsible parties adopt a more prudent approach following distortions in the financial markets.

### Impact studies

#### ● Fourth quantitative impact study.

Impact studies, especially the quantitative impact studies (QIS), are highly significant for the Solvency II project. Since 2005, these studies have given the Commission an overview of the possible consequences for the insurance industry of proposed amendments to the law. The impact studies serve additional objectives alongside the quantitative assessment of legal consequences. The studies give the undertakings information on the concrete structure of Solvency II, so that they can prepare themselves for any amendments in good time. They can also participate in the political process by submitting proposals for improvement. Furthermore, academic discussion is also being triggered in the areas which represent new ground for Solvency II, e.g. the issue of valuation principles.

In the year under review, CEIOPS carried out the fourth impact study on Solvency II (QIS 4) for the European Commission. The quantitative results of the study show that the German insurance industry is well placed. As at the reporting date at the end of 2007, nearly all participating insurers were in a position to meet the newly envisaged solvency requirements. In comparison with the current rules, the undertakings' free capital (i.e. in excess of the solvency requirements) fell slightly on average amongst the life insurers. In contrast, a marked increase was observable amongst the property and casualty insurers.

#### ● German involvement outstanding.

Across Europe, around 1,412 undertakings participated in QIS 4 this year, 37% more than took part in the third impact study. Thus the Commission's target figure of 25% of undertakings with operations in Europe was achieved. With 214 undertakings from Germany taking part, its level of participation continues to be high compared with the rest of Europe. This demonstrates not only how much interest there is in Solvency II but also the undertakings' desire and willingness to make use of the opportunities available to help shape the process successfully. For the first time, CEIOPS also incorporated a full group survey into the impact study. 111 groups from 16 European countries, as well as Switzerland, took part. 60% of the groups operate on a cross-border basis. In Germany, 20 insurance groups decided to participate. A further innovation was the introduction of captives as a company category in its own right. The term "captives" is used to designate primary insurers or reinsurers which, as subsidiaries of mostly larger, multinational undertakings, (re)insure risks emanating from their own group of companies. Captives thus represent a form of self-insurance, as claims are covered by the group's own capital.

#### ● Commission performs second impact assessment.

In parallel with the quantitative impact studies carried out, the Commission also compiles so-called impact assessment reports on a regular basis. These provide primarily a qualitative assessment of legal consequences and thus play an important role in the European legislative process. An impact assessment report is compiled for all important planned legislation in the EU. The reports are designed to ensure that, in terms of European legislation, questions are asked not only regarding the

achievement of planned objectives but also with respect to the possible economic consequences of these objectives and the costs involved in implementing them.

Whereas the first impact assessment report of mid-2007 was still concerned with the macroeconomic consequences of Solvency II, the second impact assessment analyses the impact on industry, policyholders and supervisory authorities of the various methods for calculating the MCR. The second impact assessment also looks at capital add-ons, the consideration of diversification effects, the group support regime and reporting to the supervisory authorities. CEIOPS began work for the Commission on the second impact assessment in mid-2008. The result is set to be published in autumn 2009.

## 4 Accounting

● European Commission recognises equivalence of accounting standards.

In December 2008, the EU Commission acknowledged that the accounting standards of a number of non-Member States were equivalent to the International Financial Reporting Standards (IFRS) based on the European Union version: the USA, Japan, China, Canada, South Korea and India. The ruling by the Commission and the European Parliament had been preceded by many years of preliminary work by CESR. However, the EU will observe and monitor developments in China, Canada, South Korea and India until 2011. Key criteria for the recognition of standards for an unlimited period are the progress made in convergence and the development of enforcement procedures. The criterion of equivalence as defined by CESR and the Commission is met if investors make the same investment decisions irrespective of whether IFRS financial statements or other financial statements from non-Member States are available. In addition, equivalence must be underpinned by secure enforcement procedures for investors and reliable audit certificates. The ruling ensures legal certainty for issuers in the relevant countries with respect to the access and retention rules for stock exchanges within the EU.

● BaFin discusses cash value approaches.

Particularly in times of crisis, it is important for financial reporting to retain its credibility. However, the crisis on the financial markets has exposed weaknesses in existing accounting regulations, e.g. in the calculation of the fair value of financial instruments on disrupted or inactive markets as per IAS 39. The issue shaped discussions by national and international committees of experts in 2008 and will remain topical in 2009. A possible revision of valuation regulations should have as its main objective the calculation of a largely undistorted market or transaction price adequately reflects the actual economic value of a financial instrument as at a particular reporting date. This value should, however, also be credible and verifiable. In the year under review, BaFin has dealt in detail with valuation issues and has met with specialist representatives from the undertakings subject to supervision and with their auditors. Discussions revealed that most



notably the valuation of financial instruments on the basis of discounted payment flows expected in the future appears to be particularly informative. Using special cash-value-oriented model methods, it is possible to adjust a number of effects which can be observed due to the crisis – e.g. increased volatility in premiums for the liquidity risk – in the light of historical values. Although exaggerations in the market data caused by the crisis are not incorporated in full in the valuation of financial instruments, the primacy of market valuation is nevertheless still upheld. Under no circumstances may subjective estimates from company management be used as a substitute for objective market data, as this would harbour the risk of possible result-oriented accounting and thus reduce the credibility of the information. A further advantage of these cash-value-oriented model processes based on (possibly scaled) market-related data lies in the fact that a smooth transition to a pure market valuation is possible if and when the market stabilises in the future. In December 2008, representatives from BaFin presented such a valuation procedure to a meeting of the Technical Expert Group of the European Financial Reporting Advisory Group (EFRAG).

#### **Measures of value in accounting**

In accounting, there are basically two measures of value for the valuation of financial instruments: at amortised cost, i.e. by the purchase price extrapolated from mathematical processes, or at fair value. In accordance with German commercial law, calculation of fair value is – for the time being, at least – restricted to the case of unscheduled depreciation. In international accounting, however, e.g. according to the IFRS and US-GAAP, valuation at fair value is obligatory in principle for all financial instruments that form part of a trading portfolio. For these, fair value can either be calculated on the basis of observable market parameters or be incorporated into subjective assessments through the application of alternative valuation methods. For the calculation of the fair value of financial instruments, German commercial law recommends above all using prices which have arisen on active markets. In this context, determining the meaning of the term “active market” is crucial; in other words, if there is no active market, alternative valuation methods must be used, such as comparative value and model value methods. Comparative value methods are based on the current fair value of another, essentially identical, financial instrument or on the prices from the most recent transactions for the actual financial instrument in question. Model value methods include cash-value methods, e.g. the discounted cash flow approach, and option price models. It is up to the accounting institution to select one from amongst the admissible methods; the auditor must then approve the method. The financial crisis has highlighted just how important a clear-cut definition of “active markets” actually is, as many market data observed during the crisis were typically based on “non-ideal” behaviour. The IFRS, however, stipulate: typically, the ideal fair value is the agreed price for a transaction effected under normal market conditions between competent, mutually independent market participants.

- CEBS and CESR on problems in the valuation of complex and illiquid financial instruments.

In mid-2008, CEBS and CESR published reports on specific problems regarding the valuation of complex and illiquid financial instruments. In addition to the particular challenges involved in the valuation of these instruments, the reports also examine related problems associated with disclosure in terms of financial reporting as well as audit-related issues. Both reports proposed possible solutions, which are in line with the FSF recommendations.

- Basel Committee: strict calculation of fair value.

In 2008, the Basel Committee's Accounting Task Force focused its efforts in particular on the calculation of fair value. The crisis on the financial markets has seen the importance of this issue increase considerably. Its work was completed – for the time being – in November with the publication of a consultative paper which establishes the principles for an appropriate and comprehensible method for calculating fair value. These principles concern stringent internal processes in trading, settlement and risk controlling. Many of them can be found in comparable form in the MaRisk, which also sets out minimum requirements for the trading-related processes of credit institutions.

- IOSCO on information regarding accounting standards.

In February 2008, IOSCO called on listed companies to give investors clear and appropriate information on the accounting standards which they use to compile their financial statements. The background to this is the fact that balance sheets drawn up in accordance with national accounting standards modelled on the IFRS can exhibit particular features specific to individual countries. For instance, if country-specific "carve-out" regulations have been adopted, which permit the non-application of certain accounting standards, IOSCO requires that these be disclosed.

The **International Accounting Standards Board (IASB)** is a body which formulates and approves international accounting standards. It is made up of auditors, analysts and practitioners. As International Accounting Standards (IAS)/International Financial Reporting Standards (IFRS), the IASB's specifications can claim almost global recognition and are basically subscribed to by the European Union.

- SEC roadmap for the adoption of the IFRS.

The prospect of the IFRS being recognised as the authoritative set of standards for accounting worldwide increased in 2008: in November, the Securities and Exchange Commission (SEC), the US stock exchange supervisory authority, submitted for consultation a roadmap for the approval of the IFRS for capital-market-oriented US companies. The draft contains seven milestones which, according to the SEC, must be reached before it will permit accounting for capital-market-oriented US companies to be carried out in accordance with the IFRS. The authority wants to reach a basic decision by the end of 2011. Successful implementation of the roadmap would constitute a further breakthrough for the IFRS

as a global set of accounting standards. However, the political dimension of this project must not be overlooked: in January 2009, the new Chairman of the SEC, Maria Schapiro, had already adopted a more cautious attitude to the roadmap. There was criticism of the high cost of the conversion for US issuers on the one hand and doubt as to whether the IFRS were as fully developed as the US-GAAP and would be implemented consistently in practice on the other. Concerns have also been raised regarding the independence of the IASB.

● IASB draft on the consolidation of off-balance-sheet special purpose vehicles.

In the future, it can be expected that consolidated annual financial statements will be more comprehensible and easier to compare: the IASB published a draft in December 2008 which deals, among other things, with the consolidation of off-balance-sheet special purpose vehicles. IOSCO also contributed to this draft. Similarly, IOSCO is also demanding improvements in the areas of fair value and the consolidation of off-balance-sheet special purpose vehicles.

● CEBS studies on a standardised reporting system.

In the year under review, CEBS evaluated the FINREP and COREP data which the banks report to the respective national supervisory authorities. FINREP stands for Financial Reporting and deals with the reporting of information from IFRS consolidated financial statements; COREP stands for Common Solvency Ratio Reporting and deals with the reporting obligations governing supervisory own-fund requirements. The work done by COREP and FINREP is designed to represent the first step towards a standardised, EU-wide reporting framework. In 2008, the CEBS group, which has responsibility for reporting, strove in particular to formulate common definitions of data and to standardise how frequently reporting is carried out in the Member States and the manner in which it is done. It has also been able to reduce the amount of FINREP data requested by 20%.

● Number of enforcement cases in the CESR database increases.

As at 31 December 2008, CESR members had entered approximately 175 enforcement decisions in the CESR database. As in previous years, CESR has published on its website a number of current decisions in anonymous form together with the corresponding justifications, thus making interested members of the public, too, aware of these decisions. Compiling the decisions in a database and publishing a certain number of them is intended to contribute to the standardised application of international accounting standards in Europe. As the IFRS are not intended simply to be implemented within Europe but worldwide, IOSCO, too, is keeping a corresponding database ready.

## 5 International cooperation

### 5.1 Cross-border collaboration

- EU Commission proposes Supervisory Colleges.

In the year under review, the EU Commission finalised a proposal for the revision of the Banking Directive. It provides for the institutionalised establishment of collaboration between the authorities responsible for supervising groups of institutions engaged in cross-border activities. To this end, Supervisory Colleges are to be set up, which are also intended to play a crisis management role. Supervisory authorities in where branches of systemic importance operate are deemed to have a legitimate interest in information. These authorities may be represented in the Supervisory Colleges alongside the authorities responsible for the parent institution and the subsidiaries. The rights and obligations of the consolidating supervisor remain unaffected. After the negotiations at Commission and Council level have been concluded, the European Parliament must now decide on the proposals. In January 2009, CEBS published the final version of a sample MoU on the Supervisory Colleges. The CEBS sub-group, which deals with problems associated with the supervision of the at present 17 European institutions operating on a cross-border basis (SON banks), coordinates its activities within the framework of the Supervisory Colleges. The Colleges are cooperation structures underpinning collaboration between supervisors in the home country and the host country which also cover regular meetings between supervisors. The sample MoU describes the purpose of the College and the duties of those involved in it.

As a committee of the European System of Central Banks (ESCB), the **Banking Supervision Committee (BSC)** is located at the European Central Bank. Its members are representatives of the banking supervisory authorities and the central banks of the Member States of the European Union. The BSC supports the European System of Central Banks in terms of the contribution it makes to the stability of the European financial system. Its work is mainly geared to the analysis of the stability of European banking systems and structural developments in the banking sector.

- BSC supports national authorities in crisis management.

In the year under review, the BSC produced a manual which uses concrete examples to provide support in implementing a process for the early detection of the systemic effects of a crisis. The BSC devised a study to examine the question of what instruments the authorities responsible tend to use in the event of a crisis involving a medium-sized bank whose business is largely geared to the domestic market. The results were unsurprising: the instruments available to the authorities are managed in very different ways. With respect to a number of crisis management tools, the level of harmonisation is minimal. In order to achieve greater convergence, therefore, various EU Directives are already being revised.

● CEIOPS introduces peer reviews.

In 2008, CEIOPS, like the other Level 3 committees, has the option of carrying out peer reviews. These peer reviews are intended to establish whether the insurance supervisory authorities have implemented the jointly developed principles and guidelines. The first CEIOPS peer review will examine the question of whether the supervisory authorities have implemented the principles of collaboration and the exchange of information on the supervision of undertakings engaged in cross-border business.

● Dialogue with offshore financial centres remains important.

In the previous year, too, an IOSCO group carried out a great deal of work to improve the exchange of information with countries receiving large inflows of foreign capital on a regular basis because they lack stringent regulations, so-called offshore financial centres (OFC). The IOSCO MoU serves as a basis for the dialogue, held with five countries in 2008. Through extensive changes to its laws, one of the five countries has been able to eliminate the weaknesses relating to international collaboration that had been identified by IOSCO and was about to sign the IOSCO MoU at the time of going to press. The dialogue with this country has thus been brought to a successful conclusion. Another two countries have also made progress, although a number of questions remain, and the same goes for two further countries which are party to this dialogue.

● New cooperation agreement with the FSA.

#### **Cross-border supervisory cooperation in accordance with the MiFID**

After negotiations lasting several months, BaFin agreed a Common Oversight Programme with the British FSA in 2008. The agreement applies to a number of German credit institutions whose importance is systemic in nature given that they play an important role on the English capital market through their branches in London. Thanks to the agreement, BaFin is now in a position to be more closely involved in the supervision of the branches. As far as the institutions under supervision are concerned, this means that it is no longer possible to fall back on the more favourable form of supervisory legislation, i.e. supervisory arbitrage. In accordance with the MiFID, the securities-related supervision of the branches is the joint responsibility of the supervisory authorities in the home and host countries. The European supervisory authorities therefore have the option of either making a Standing Request of Assistance to the supervisory authority of another Member State or concluding a Common Oversight Programme with the supervisory authority. Whereas a Standing Request of Assistance delegates a substantial proportion of the securities supervision of a branch to the supervisory authority in the host country, a Common Oversight Programme involves the supervisory bodies of both host and home countries coordinating their supervisory measures closely with one another in order to effect one-stop supervision of the branch with duties divided in a sensible manner.

● Further agreements envisaged.

A further agreement in the form of a Common Oversight Programme is to be concluded with the French AMF, one with the Italian Consob and another with the Spanish CNMV. Whether such a Common Oversight Programme lends itself to German securities

supervision in individual cases depends, among other things, on the nature and scope of the business. Furthermore, apart from the number of customers and the customer structure, what is also significant is the question of whether systemic importance accrues to the business from the point of view of the host country. If not, it tends to choose the more efficient option of delegating a part of its supervisory duties to the European supervisory authorities by agreeing a Standing Request of Assistance. In 2008, BaFin concluded such agreements with the supervisory authorities in Belgium, Greece, Austria, Sweden, Slovakia and the Czech Republic.

IAIS/CGAP supports the granting of micro-insurance.

A joint working group comprising members of IAIS and CGAP (Consultative Group to Assist the Poor) is to help emerging markets provide poor sections of the population with micro-insurance. Germany is represented in this working group by BaFin and the Deutsche Gesellschaft für Technische Zusammenarbeit (German Organisation for Technical Cooperation). By 2010, the group will compile a set of guidelines for the supervision of micro-insurers.

It is currently on a fact-finding mission. For instance, it initiated a five-nation study on micro-insurance in Columbia, India, South Africa, Uganda and the Philippines in the year under review.

## 5.2 Memoranda of Understanding

New MoU in insurance supervision.

BaFin concluded two new MoU on cooperation in insurance supervision in 2008. It signed one such agreement with the New York State Insurance Department in June and another in October with the Insurance Authority of the Hong Kong Special Administrative Region of the People's Republic of China. MoU enable BaFin and the respective MoU partner to cooperate more closely with each other. They also set out the formal basic principles for consultations and coordination and provide for the authorities to exchange information which is relevant for the supervisory and regulatory duties of those involved in the MoU.

Agreements with authorities in the Arabian peninsula.

The subject of an MoU which BaFin concluded with the Qatar Financial Centre Regulatory Authority (QFCRA) in May 2008 is not only cooperation in insurance supervision but also cooperation in the supervision of credit institutions, financial service providers and securities trading. Founded in 2005, the QFCRA acts as the integrated financial supervisory authority for the "Qatar Financial Centre" free-trade zone located in Qatar. At the beginning of the year, BaFin also signed an agreement on cooperation with the securities supervisory authority in the United Arab Emirates. The Emirates Securities & Commodities Authority, which has been in existence since 2000, monitors securities and commodities markets, stock exchanges and settlement systems in the UAE.

Cooperation with Croatian supervisors.

On the basis of MoU, BaFin has been collaborating with the Croatian financial supervisory authorities since 2008: with the Croatian HANFA regarding securities and insurance supervision and with the Croatian National Bank regarding banking supervision.

IAIS MMoU offers an instrument for the exchange of information.

In 2008, IAIS tackled the remaining organisational tasks required for the implementation of the IAIS MMoU. With its multilateral MoU, IAIS offers insurance supervisory authorities worldwide a sound instrument for the increased exchange of information and for cooperation in all areas including crisis management. Mutual trust and the reliable observance of confidentiality are essential for the exchange of information and for cooperation between supervisory authorities at international level. For this reason, a so-called IAIS validation team checks whether the legal system and administrative procedures of each supervisory authority wishing to sign the MMoU comply with the minimum requirements laid down in the MMoU. With 17 MMoU applications (as at March 2009), the process has started well.

Table 2

### Memoranda of Understanding (MoU) 2008

Banking supervision		Securities supervision		Insurance supervision	
Australia	2005	Argentina	1998	Australia	2005
Belgium	1993	Australia	1998	China	2001
Brazil	2006	Brazil	1999	Dubai	2006
China	2004	China	1998	Estonia	2002
Denmark	1993	France	1996	<b>Hong Kong</b>	<b>2008</b>
Dubai	2006	Hong Kong	1998	California	2007
Estonia	2002	Italy	1997	Canada	2004
France	1992	Jersey	2001	Korea	2006
Greece	1993	Canada	2003	<b>Croatia</b>	<b>2008</b>
United Kingdom (BE/FSA)	1995	<b>Croatia</b>	<b>2008</b>	Lithuania	2003
United Kingdom (SIB/SROs)	1995	Luxembourg	2004	Nebraska	2007
United Kingdom (BSC)	1995	Poland	1999	<b>New York</b>	<b>2008</b>
Hong Kong	2004	Portugal	1998	<b>Qatar</b>	<b>2008</b>
Ireland	1993	<b>Qatar</b>	<b>2008</b>	Romania	2004
Italy (BI)	1993	Russia	2001	Slovakia	2001
Italy (BI-Unicredit)	2005	Switzerland	1998	Czech Republic	2002
Korea	2006	Singapore	2000	Hungary	2002
<b>Croatia</b>	<b>2008</b>	Slovakia	2004	USA (OTS)	2005
Latvia	2000	Spain	1997		
Lithuania	2001	South Africa	2001		
Luxembourg	1993	Taiwan	1997		
Malta	2004	Czech Republic	1998		
Netherlands	1993	Turkey	2000		
Norway	1995	Hungary	1998		
Austria	2000	USA (CFTC)	1997		
Philippines	2007	USA (SEC)	1997		
Poland	2004	USA (SEC)	2007		
<b>Qatar</b>	<b>2008</b>	<b>UAE</b>	<b>2008</b>		
Romania	2003	Cyprus	2003		
Russia	2006				
Slovenia	2001				
Spain	1993				
South Africa	2004				
Hungary	2000				
USA (OCC)	2000				
USA (NYSBD)	2002				
USA (OTS)	2005				
USA (FDIC)	2006				
USA (SEC)	2007				

### 5.3 Technical cooperation

In the year under review, BaFin continued to advise and support foreign supervisory authorities in the development of a new supervisory system.

#### ● Cooperation with China.

The Chinese financial market is gaining in importance. Delegations from the Chinese supervisory authorities and staff from Chinese financial institutions came to BaFin in the year under review for fact-finding visits and seminars. In February and October, two BaFin employees reported on issues relating to securities and insurance supervision in Beijing and Dalian. This collaboration will continue in 2009.

#### ● Good contacts in Croatia, Ukraine, South Korea and Russia.

In terms of BaFin's cooperation with Ukraine and Croatia, contacts with the financial supervisory authorities were strengthened in 2008. In February, a delegation from the Croatian securities supervisory authority HANFA visited Frankfurt to find out about the implementation of the Markets in Financial Instruments Directive (MiFiD). Representatives from the Ukrainian securities supervisory authorities, too, visited BaFin in September to exchange information. The delegation was accompanied by Ukraine's First Deputy Minister of Finance. Closer cooperation is planned between the German and Ukrainian supervisory authorities for 2009.

Contacts with South Korea's financial markets supervisory authority are being maintained. In June and October, staff from this authority completed work placements lasting several weeks in the areas of securities and insurance supervision. In October, a BaFin employee gave a presentation in Seoul on issues relating to securities supervision.

Within the framework of collaboration with Russia, contacts with the securities and insurance supervisory authorities have strengthened: a delegation from the Russian securities supervisory authority attended seminars held by BaFin. In addition, a BaFin employee participated in a further education event in Moscow for Russian insurance supervisors.

#### ● Support for Thailand, Serbia, Armenia and Moldova.

In 2008, BaFin was able to maintain a reasonable level of contact with the insurance supervisory authority in Thailand. A four-man delegation gathered information in May on selected topics connected with supervision. In the year under review, collaboration with the Serbian insurance supervisory authority on the implementation of European Directives continued. BaFin also hosted representatives from the Armenian insurance and securities supervisory authorities in the context of fact-finding visits. Contacts have been developed between BaFin and the National Commission of Financial Markets (NCFM) of the Republic of Moldova.





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## IV Supervision of insurance undertakings and pension funds

### 1 Basis for supervision

#### 1.1 Implementation of the Acquisition Directive

On 27 August 2008, the Federal Cabinet adopted the Act on the Implementation of the Acquisition Directive.<sup>4</sup> The amendments to the Insurance Supervision Act (Versicherungsaufsichtsgesetz – VAG) provided for in this Act are set to enter into force in March 2009. The Acquisition Directive is based on a feasibility study undertaken by the EU Commission on behalf of EU finance ministers. In this study, the Commission was charged with investigating possible obstacles to cross-border mergers and acquisitions in the banking sector.

The aims of the Acquisition Directive are to establish a transparent procedure for the acquisition of a significant participation in an insurance undertaking or a bank by a natural or legal person and to effect procedural harmonisation in the individual EU Member States. It is intended to create legal certainty, clarity and predictability in the supervisory assessment process. In order to achieve this, the Directive establishes a definitive standardised list of investigation criteria, on the basis of which the supervisory authorities can prohibit the acquisition or the increase of a significant participation. Implementation of the Acquisition Directive will entail a revision of section 104 VAG. To date, section 104 VAG has been interpreted by Circular R 4/98. Parts of this Circular, which governs details on the form and content of reports, are to be replaced by BaFin's Holder Control Regulation in 2009.

As far as the supervisory is concerned, deadlines will be set by which it has to provide confirmation of receipt of the complete report, request additional documentation, if any, and carry out the audit procedure. In principle, the absolute deadline for a supervisory assessment will be set at 60 working days from receipt of a complete report. A request for additional information will lead to an extension of the deadline by a maximum of 20 working days in the case of acquirers domiciled in the EU and by a maximum of 30 working days in all other cases.

In future, it will also be possible for a prohibition to be based on one of the following: the future manager of the insurance undertaking is not reliable or not sufficiently qualified; the report is

● Provisions governing participating interests are being revised.

● New regulation for procedures.

● New reasons for prohibition.

<sup>4</sup> Bundestag printed paper 16/10536, Directive 2007/44/EC dated 05.09.2007, OJ EU No. L 247 dated 21.09.2007, p. 1.

incomplete or inaccurate or does not meet the requirements of the Holder Control Regulation; a connection exists with money laundering or the financing of terrorism; or the entity subject to notification requirements is not as financially sound as required.

● Cooperation with other EU supervisory authorities.

The Insurance Supervision Act (section 111f (5) VAG) stipulates that supervisory bodies in EU countries have to work together and exchange information which is relevant for assessing the suitability of the acquisition if those acquiring the participation are domiciled in another Member State and are subject to supervision in that State.

## 1.2 Ordinances

### Holder Control Regulation

BaFin made the draft of the Holder Control Regulation available for public consultation at the end of 2008. The Holder Control Regulation is binding and stipulates which documents and explanatory notes from the report on the acquisition or increase of a participation are to be submitted for significant participations in accordance with section 104 VAG. With the regulation, BaFin is implementing a requirement of the Acquisition Directive and a joint recommendation from the 3Level3 committees (3L3) CEBS, CEIOPS and CESR, which interprets this Directive. After the consultation was complete, the Holder Control Regulation entered into force in March 2009 together with the Act on the Implementation of the Acquisition Directive.

● Aims of the Holder Control Regulation.

The binding nature of the regulation covering the notification and assessment process is intended to ensure that the entity subject to notification requirements is aware of its obligations even before submitting its notification of intent and can therefore contribute to the rapid start-up of the inspection process. At the same time, the Holder Control Regulation establishes a transparent assessment procedure. Thus the procedure for supervisory inspections not only becomes clearer and more predictable, it also ensures greater legal certainty.



### Financial Conglomerates Solvency Regulation

The Financial Conglomerates Solvency Regulation (Finanzkonglomerate-Solvabilitat-Verordnung – FkSolV) stipulates that a financial conglomerate must, at all times, retain adequate own funds to meet the solvency requirements at conglomerate level to a sufficient extent. BaFin amended the regulation in July 2008 and implemented a method for calculating the amount of own funds available to the financial conglomerate as a whole based on the conglomerate’s consolidated financial accounts.

In a further amendment at the end of 2008, BaFin enabled the insurers of a financial conglomerate to leave aside losses and

reserves from fixed-income securities relating to a particular item when calculating the amount of available own funds.

### **Solvency Adjustment Ordinance**

In February 2008, BaFin amended the Solvency Adjustment Ordinance (Solvabilitätsbereinigungs-Verordnung – SolBerV) in order also to subject reinsurers and reinsurance groups to the rules laid down by the ordinance. SolBerV now stipulates the principles and methods used in calculating so-called adjusted solvency, i.e. the financial resources available to the primary insurer and the reinsurer, taking into account cross-shareholdings among the companies of the group. It became necessary to amend the SolBerV after the European Reinsurance Directive was incorporated into the VAG.

### **Finite Reinsurance Ordinance**

The Ordinance on finite reinsurance contracts and contracts without sufficient risk transfer (Finite Reinsurance Ordinance (Finanzrückversicherungsverordnung – FinRVV)) entered into force on 26 July 2008. It represents an integral part of the risk-based reorientation of BaFin. The FinRVV regulates the requirements regarding financial reinsurance contracts and specifications for internal processes. In particular, reinsurers have to prove, by means of a risk verification process (risk transfer test), that the financial reinsurance contracts involve a sufficient risk transfer. The FinRVV contains transitional provisions for financial reinsurance contracts and contracts without sufficient risk transfer which had already been concluded at the time when the ordinance entered into force.

### **Amendment to the Calculation Ordinance**

By amending the Calculation Ordinance (Kalkulationsverordnung – KalV) in December 2008, the BMF created the condition for implementing as planned the reform of the private health insurance system by 1 January 2009. Back in March 2007, the legislator had already amended sections of the VAG and KalV via the Act on the Strengthening of Competition in Statutory Health Insurance (GKV-Wettbewerbsstärkungsgesetz – GKV-WSG). The BMF now amended the ordinance once again to take into account experiences which were not available at the time of the adoption of the GKV-WSG.

● Rules for changing health insurance are being amended.

● Minimum retention period of 18 months for existing policyholders at the basis rate.

A policyholder's fundamental entitlement to a change of rate is based on section 204 (1) no. 2b VVG. This stipulates that, based on an existing insurance contract, policyholders are entitled to request the health insurance undertaking to accept their claims for a switch to other rates with comparable coverage while maintaining the rights and ageing provision entitlements acquired under the contract. If the benefits accruing from the rate to which policyholders wish to switch are higher or more comprehensive compared with their current rate, the insurer can, with respect to the additional benefit, demand an exclusion of benefits or an appropriate risk premium and thus also a waiting period. The new

KaIV now specifies how to proceed in the event that insured persons have made use of their entitlement to switch to the basic rate and stipulates that such an insured person has to remain at the basic rate for a minimum of 18 months after switching. Only after expiry of this 18-month period may policyholders switch to a premium rate offered by the same health insurer or to the basic rate offered by another insurer and carry over the complete transfer value.

Among other reasons, such a minimum retention period is required because entitling a policyholder to switch from the basic rate without any restrictions could lead to a risk separation in the basic rate. In this event, the premium for existing medical conditions in the basic rate would rise, and the premium for the capping of contributions in the basic rate would also rise in the other rates. On the one hand, the new regulation thus protects persons insured under the basic rate against increased premiums. On the other hand, it helps to stabilise the premium for the remaining portfolio-insured persons. A period of 18 months seems to be appropriate for achieving the desired purpose. Incidentally, the minimum retention period matches the retention period relating to statutory health insurance after exercising the right of option (section 175 (4) SGB V).

● Provisions for calculating the transfer value were revised.

Furthermore, the new KaIV defines provisions for the general calculation of the transfer value. The ordinance contains a workable method for calculating the transfer value for contracts concluded before 1 January 2009. In addition, it is stipulated that, in the event of a change of insurer, the transfer value carried over may not be diminished via zillmerisation at the new insurer.

### **Ordinance on Minimum Allocation for Pension Funds**

The Ordinance on minimum bonuses and rebates for pension funds (Ordinance on Minimum Allocation for Pension Funds) entered into force in December 2008. In accordance with this ordinance, pension funds have to give with-profit pension contracts a sufficient minimum allocation to the provision for bonuses and rebates (Rückstellung für Beitragsrückerstattung – RfB) in line with the capital investment result, risk result and other result. In terms of its contents, the ordinance closely mirrors the Minimum Allocation Ordinance from the field of life insurance. Relatively small differences exist due to the specific features of pension funds, which for instance have no “existing portfolio”. Pension funds are to apply the Ordinance on Minimum Allocation for Pension Funds for the first time in the first financial year beginning after the 31 December 2007.

## **1.3 MaRisk VA**

Following extensive preparatory work, in January 2009 BaFin published the Minimum requirements for risk management for insurers (Mindestanforderungen an das Risikomanagement von Versicherern – MaRisk VA) in Circular 3/2009 (VA).

- Planning security for implementing section 64 a VAG.

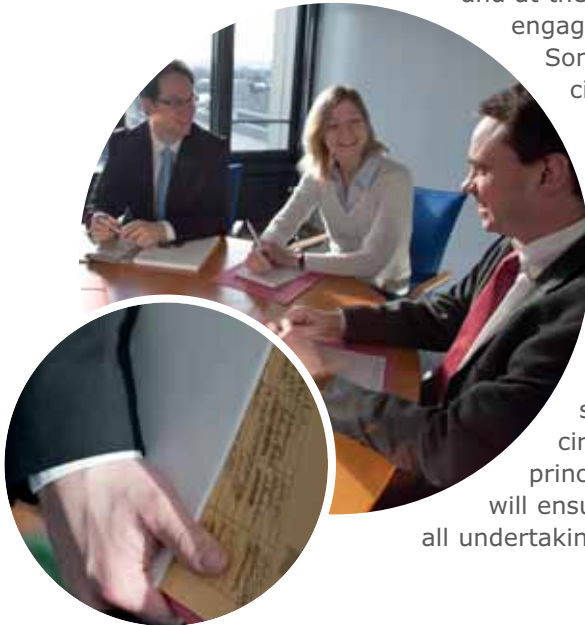
With the MaRisk VA, BaFin is making clear what priorities it will set in terms of auditing risk management. The circular interprets section 64a VAG for the supervisory body in a legally binding manner; it has been in force since January 2008 and defines the minimum standards for a proper business organisation and, above all, for an adequate level of risk management by insurers. With the MaRisk VA, the undertakings subject to supervision thus have a degree of security when they are planning the further development of their risk management systems. Section 64 VAG and the MaRisk VA also contain special requirements which apply to outsourcing and service agreements.

- Intensive dialogue with the public.

Publication of the MaRisk VA was preceded by a wide-ranging and intensive dialogue with companies, associations and interested members of the public. BaFin received numerous ideas and suggestions which were presented in the context of a consultation and at the subsequent oral hearing. The opportunity to engage in a dialogue met with a great response.

Some 200 experts participated in the hearing. The circular also benefited from insights which BaFin had gained from the financial crisis. These concerned, for example, incentive and payment systems and the stricter separation of incompatible duties.

The current state of the financial markets illustrates how important it is to stimulate the further development of the quality of risk management systems for undertakings subject to supervision. The way in which the circular was drafted and the fact that the principle of proportionality was strictly adhered to will ensure that the minimum standards can be met by all undertakings.



## 2 Ongoing supervision

### 2.1 Authorised insurance undertakings and pension funds

In 2008, the number of insurance undertakings subject to supervision by BaFin fell further to 626 (previous year: 631), of which 607 were and 19 were not actively engaged in business activities. The information on business development in 2008 includes the public-law insurance undertakings subject to supervision by the individual federal states (of which nine were and two were not actively engaged in business activities). A sector breakdown is provided in the table below:

Table 3

**Number of supervised insurance undertakings (IU) and pension funds<sup>5</sup>**

	IU with business activity			IU without business activity		
	Federal supervisor	State supervisor	Total	Federal supervisor	State supervisor	Total
Life insurers	99	3	102	10	0	10
Pensionskassen	153	0	153	0	0	0
Death benefits funds	41	0	41	0	0	0
Health insurers	51	0	51	0	0	0
Property and casualty insurers	222	6	228	5	2	7
Reinsurers	41	0	41	4	0	4
Total	607	9	616	19	2	21
Pension funds	27	0	27	0	0	0

**Initiation and cessation of insurance business****Life insurers**

During 2008, BaFin authorised one new insurance undertaking to conduct life insurance business – three German life insurance undertakings ceased trading. Five branches (Niederlassungen – NL) of undertakings from EU countries were set up (Luxembourg, Republic of Ireland). 21 foreign life insurers from the EEA registered to commence the provision of services (Dienstleistungsverkehr – DL) in Germany (previous year: 11). A number of service providers expanded their business operations.

Table 4

**Registrations by EEA life insurers**

Country	DL*	NL**
United Kingdom	6	
of which Gibraltar	0	
Ireland		2
Belgium	2	
Netherlands	2	
Greece	1	
Liechtenstein	4	
Malta	1	
Spain	4	
Poland	1	
Luxembourg		3

\* Cross-border services as defined in section 110a (2a) VAG.

\*\* Branch services as defined in section 110a (2) VAG.

**Health insurers**

BaFin authorised one public limited company to conduct health insurance business in 2008. One health insurance undertaking was merged with another company in the year under review.

<sup>5</sup> The data does not include small mutual societies (kleinere Versicherungsvereine auf Gegenseitigkeit) which operate on a mainly regional basis and are supervised regionally (see BaFin statistics for 2007 – primary insurance undertakings, p. 8, table 5).

### Property and casualty insurers

During 2008, BaFin authorised one public limited company to conduct property and casualty insurance business. Three property and casualty insurers ceased trading. Foreign property and casualty insurers from the EU set up four branches, one each from Austria and Denmark and two from the United Kingdom. 42 insurance undertakings from the EEA registered to commence the provision of services in Germany (previous year: 47). Additionally, a number of insurance undertakings that were already authorised reported their intention to expand business operations. Compulsory insurance is still only offered on a small scale and is generally limited to motor vehicle insurance. In 2008, too, some insurers ceased their service activities in Germany.

Table 5

#### Registrations by EEA property and casualty insurers

Country	DL*	NL**
United Kingdom	9	2
of which Gibraltar	2	0
Ireland	2	
France	2	
Netherlands	4	
Spain	1	
Denmark	5	1
Greece	2	
Malta	2	
Sweden	3	
Bulgaria	1	
Romania	2	
Lithuania	1	
Luxembourg	3	
Italy	3	
Czech Republic	2	
Austria		1

\* Cross-border services as defined in section 110a (2a) VAG.

\*\* Branch services as defined in section 110a (2) VAG.

### Reinsurers

In 2008, BaFin authorised one public limited company to conduct reinsurance business. Over the same period, two companies ceased their activities as independent German reinsurers in the wake of intracompany restructuring.

### Pensionskassen and pension funds

In the year under review, BaFin authorised one Pensionskasse to conduct business operations. One new pension fund was set up. In addition, BaFin took over the supervision of a Pensionskasse from the supervisory authority of the individual federal state which had previously been responsible for it. The portfolio of one Pensionskasse was transferred to a life insurance undertaking.

There are thus currently 153 Pensionskassen and 27 pension funds subject to supervision by BaFin. At the end of the year under review, the authorisation procedure for the business operations of one pension fund was still ongoing. A further application for the authorisation of business operations was withdrawn by the applicant.

In the year under review, applications were submitted by five occupational pension schemes domiciled in another EU Member State, of which four were from the United Kingdom and one from Austria.

## 2.2 Interim reporting

### 2.2.1 Financial market crisis

Distortions in financial markets have not left German insurers unscathed either.

Since the collapse of the American investment bank Lehman Brothers in September 2008, the financial market crisis has spread dramatically across the world. By their nature, insurers are affected by developments on the international capital markets, not least because they are major institutional investors. In addition, the undertakings' actuarial practice is influenced by developments on the capital markets and by the impending weakening of the global economy.

#### Task force

In the wake of the financial crisis, the insurance supervisory body set up an internal task force charged with observing the markets closely and transforming any early warning signs into concrete proposals for operational insurance supervision. The task force receives weekly reports from 26 insurance groups and six individual underwriters on changes to and developments in the risk situation of groups of companies or of individual subsidiaries. In particular, the undertakings report on their equity exposure and their write-down requirements as well as hidden liabilities, liquidity, group and solo solvency, and coverage of technical liabilities at book value and fair value. These reports are supplemented by ad hoc surveys of the undertakings, also carried out on a weekly basis, the main issues of which are based on general developments on the international financial markets. These ad hoc surveys provide the task force with up-to-date information which goes beyond the regular reports submitted to BaFin.

The reports submitted to date by the insurers involved do not indicate any concrete threats posed to individual insurers. The insurers have been following developments on the capital markets closely, responding to changes by rearranging their portfolios, substantially so in some cases. Due to the strict supervisory provisions for the investment of restricted assets, the insurers' investments are widely diversified. Defaulting individual debtors thus have less of an impact on the insurers than has been observed with respect to other institutional investors. Nevertheless, many insurers are having to make sizeable write-downs on their investments due to share price losses and deteriorations in creditworthiness. The insurers are limiting the impact on their balance sheet partly through the formation of hidden liabilities based on section 341b (2) sentence 1 HGB.



At the end of the year under review, it had not yet been possible to gauge precisely how much of the insured losses could be ascribed to the financial market crisis. In total, losses reported to date are in the low hundreds of millions. Credit insurers are anticipating a significant increase in loss frequency. Based on experiences from previous economic crises, the insurers are also expecting an increase in the number of claims with respect to the liability of auditors, tax consultants and lawyers. Legal expenses insurers are dealing with numerous claims notifications due to mis-selling allegations in connection with the purchase of financial products from banks.

### 2.2.2 Business development<sup>6</sup>

#### Life insurers

During 2008, the volume of newly activated policies in the area of direct life insurance fell by 13.2% from 7.45 million to 6.47 million. At €219.6 billion, the underwritten amount of new insurance policies was 2.7% lower than in the previous year (previous year: €225.8 billion).

The share of mixed endowment policies in relation to new contracts was down again year-on-year, falling from 18.7% to 14.4% and thus continuing the trend set in 2007. Term insurance in numbers accounted for 28.2%, up from 26.8% a year earlier. The share of annuities and other life insurance rose from 54.4% to 57.4%. Endowment insurance represented just 8% of the underwritten amount on new policies, compared with 11% in the previous year. Term insurance accounted for 32.4%, down from 34.7% in the previous year. The share of annuities and other life insurance rose from 54.3% to 59.7%, thus continuing the trend of the previous year.

Early withdrawals (surrender, conversion into paid-up policies and other early withdrawals) affected 3.6 million contracts, up from 3.5 million a year earlier, thus reaching the level attained in 2006. The total underwritten amount of the contracts that were withdrawn early, at €113.8 million, was higher than in previous years (€108 million in 2007 and €110 million in 2006). Compared with the previous year, in the case of endowment policies early withdrawals fell by 6.4% in numbers of policies and by 5.7% in the underwritten amount.

The total number of direct insurance policies as at the end of 2008 stood at 92.5 million contracts (-2.5%), with a total underwritten amount of €2,491.6 billion (+0.9%). The share of mixed endowment policies fell from 50.9% to 47.3% and the underwritten amount from 39.8% to 36.4%, thus continuing the downward trend of the previous year. With a share of 14.5% in number and 21.3% in the underwritten amount, the trend for term

<sup>6</sup> The figures for 2008 are based on interim reporting as at 31 December 2008 and are therefore only provisional figures.

life insurance remained broadly unchanged in comparison with the previous year. Annuities and other life insurance continued their positive development, with the share accounted for by the number of contracts up from 34.5% to 38.2% and that of the underwritten amount also up, from 39.3% to 42.2%.

Gross premiums posted in direct insurance business rose from €74.8 billion to €75.3 billion. The share of endowment insurance was down again, from 42.8% to 41%, whilst the share of annuities and other life insurance rose from 51.9% to 53.5%.

### Health insurers

In 2008, gross premiums posted in direct health insurance business rose by 2.9% to €30.3 billion. The number of insured natural persons increased by 5.7% to 33.7 million.

### Property and casualty insurers

In 2008, property and casualty insurers saw gross premiums posted in direct insurance business remain virtually unchanged at €58.2 billion (previous year: €58.6 billion).

Gross payments for insurance claims relating to the financial year under review fell by 4.8% to €20.5 billion, whilst gross payments for claims from previous years rose by 1.5% to €13.6 billion. Gross provisions for individual insurance claims relating to the financial year under review stood at €14.9 billion, down from €15.0 billion a year earlier, and gross provisions for individual insurance claims relating to previous years totalled €45.2 billion, up from €44.8 billion a year earlier.

Motor vehicle insurance, with posted gross premiums totalling €20.2 billion, was the biggest class by far. This amounts to a fall of 1.5% (previous year: -2.6%). Total gross payments for insurance claims relating to the financial year under review rose by 3.2%, with 3.9% more being paid out for insurance claims from previous years. Gross provisions for individual claims relating to the financial year under review and for outstanding claims from the previous year were much the same as in the previous year, at €5.6 billion and €23.8 billion respectively.

In the area of general liability insurance, property and casualty insurance undertakings collected total premiums of €7.7 billion (+0.5%). The undertakings paid out 4.1% less for claims relating to the financial year under review and 6.0% less for claims relating to the previous year. Gross provisions for individual claims, which are particularly important in this insurance class, rose for outstanding insurance claims relating to the financial year under review by 0.9% (previous year: +10.9%) to €2.3 billion, and they were up for outstanding insurance claims relating to the previous year by 2.9% (previous year: +3.7%) to €12.7 billion.



In the area of fire insurance, undertakings posted gross premiums of €1.8 billion (-4.9%). Gross payments for claims relating to the financial year under review fell by 10.6%.

Combined, comprehensive residential buildings insurance and comprehensive household insurance generated premiums of €7.0 billion (+4.9%). Payments for claims relating to the financial year under review fell by 22.1% year-on-year, with provisions for individual claims up by 3.4%. Payments for claims relating to previous years were down by 1.0% and provisions for claims relating to previous years were 4.6% up on 2007.

Premiums from general accident insurance totalled €6.5 billion (previous year: €6.4 billion). Gross payments for insurance claims relating to the financial year under review remained unchanged at €0.3 billion. Provisions for individual claims outstanding from 2008 were up by 6.5% on the previous year.

### **Pension funds**

There is a direct connection between trends in new business for pension funds and the economic development of potential sponsoring companies. Against the background of the global financial crisis and due to liquidity shortages experienced by potential sponsoring companies in 2008, above all the transferral business relating to the non-insurance-based defined benefit as per section 112 (1a) VAG is likely to have been rather less buoyant overall. Defined contributions with minimum benefit are primarily funded by the employee as deferred compensation. Written gross premiums totalling €2.5 billion were posted, compared with €12.6 billion in the previous year. The previous year's high premium income was primarily the result of single premiums.

### **2.2.3 Investments**

Total investments of all insurers increased in 2008, up 3.3% to €1,299.9 billion (previous year: €1,286.5 billion). The proportion accounted for by properties fell to 2.0%, as a result of a decline in the book value of property investments. The proportion of investments in fund units, at 22.3%, was broadly unchanged year-on-year. These were the biggest items alongside Pfandbriefe, municipal bonds and other bonds issued by credit institutions, accounting for some 19.5%. Overall, the breakdown of individual investments was similar to the situation in 2007. The increase recorded in total investments was above average, substantially so in the case of health insurers, markedly so with regard to Pensionskassen and slightly so regarding reinsurers. In contrast, life insurers and death benefits funds as well as property and casualty insurers recorded a decline.

Table 6  
Investments 2008\*

Investments of all insurance undertakings	Balance as at 31.12.2008		Balance as at 31.12.2007*		Change in 2008	
	in € million	in %	in € million	in %	in € million	in %
Real property and equivalent rights and shares in property companies	25,722	2.0	26,565	2.1	- 843	- 3.2
Shares in funds, public investment companies and investment companies	289,325	22.3	276,853	21.5	+ 12,473	+ 4.5
Loans secured by mortgages on property	60,039	4.6	62,685	4.9	- 2,646	- 4.2
Loans against securities and receivables secured against bonds	967	0.1	3,690	0.3	- 2,723	- 73.8
Loans to EEA states, their regional governments, regional corporations, international organisations	82,233	6.3	78,599	6.1	+ 3,634	+ 4.6
Corporate loans	12,659	1.0	10,606	0.8	+ 2,053	+ 19.4
ABS	1,120	0.1	669	0.1	+ 451	+ 67.5
Policy loans	5,797	0.4	5,209	0.4	+ 588	+ 11.3
Pfandbriefe, municipal bonds and other bonds from credit institutions	253,014	19.5	255,921	19.9	- 2,907	- 1.1
Listed bonds	113,379	8.7	108,808	8.5	+ 4,571	+ 4.2
Other bonds	10,999	0.8	10,522	0.8	+ 476	+ 4.5
Receivables from subordinated debt	23,489	1.8	23,463	1.8	+ 27	+ 0.1
Participation rights	11,109	0.9	13,489	1.0	- 2,380	- 17.6
Registered debts and liquidity papers	801	0.1	2,383	0.2	- 1,582	- 66.4
Listed shares	15,790	1.2	25,866	2.0	- 10,076	- 39.0
Unlisted shares and company holdings excl. shares in private equity	133,408	10.3	131,595	10.2	+ 1,813	+ 1.4
Shares in private equity	6,568	0.5	4,695	0.4	+ 1,873	+ 39.9
Investments at credit institutions	218,973	16.8	209,942	16.3	+ 9,031	+ 4.3
Investments in opening clause	15,609	1.2	14,592	1.1	+ 1,017	+ 7.0
Other investments	18,846	1.4	20,360	1.6	- 1,514	- 7.4
<b>Total investments</b>	<b>1,299,850</b>	<b>100.0</b>	<b>1,286,513</b>	<b>100.0</b>	<b>+ 13,337</b>	<b>+ 1.0</b>
Life insurers	689,147	53.0	696,495	54.1	- 7,348	- 1.1
Pensionskassen	104,189	8.0	98,966	7.7	+ 5,223	+ 5.3
Death benefits funds	1,647	0.1	1,720	0.1	- 73	- 4.2
Health insurers	152,508	11.7	142,686	11.1	+ 9,822	+ 6.9
Property and casualty insurers	136,801	10.5	140,520	10.9	- 3,720	- 2.6
Reinsurers	215,557	16.6	206,126	16.0	+ 9,431	+ 4.6
<b>All IUs</b>	<b>1,299,850</b>	<b>100.0</b>	<b>1,286,514</b>	<b>100.0</b>	<b>+ 13,336</b>	<b>+ 1.0</b>
Primary insurers	1,084,293	83.4	1,080,388	84.0	3,905	+ 0.4

\* The 2008 figures are based on interim reporting and are only provisional figures. They may therefore differ from the figures published in the previous year.

### Pension funds

Investments for the account and risk of the pension funds rose in 2008, from €640 million to €719 million, which represents an increase in relative terms of 12.3%. In the previous year, an increase of over 26% was recorded with respect to these investments. At the balance sheet date, the non-offset hidden liabilities in the investments of the pension funds amounted to approximately €6.8 million. Several pension funds are expected to exercise the right of option as per section 341b HGB during valuation and assign specific investments to their fixed assets.

Investments for the account and risk of employees and employers were lower overall in the year under review, down from €13.4 billion to €12.7 billion. These investments consist predominantly of shares in investment funds. The financial crisis had a marked impact on the balance-sheet valuation of these assets and caused losses in market value. Initially, these so-called unrealised losses are not charged to the pension funds. This only occurs if the value falls below a minimum benefit guaranteed by the pension fund. In the year under review, this did not apply to any undertaking. All pension funds subject to supervision by BaFin were able to cover their actuarial reserves in full.

## 2.3 Solvency

● All branches of the insurance industry reported comfortable solvency figures.

According to provisional estimates, primary insurers and reinsurers were well able, on the whole, to meet the minimum capital requirements well in 2008.

### Life insurers

The solvency of life insurers remained good throughout 2008, as was shown by the evaluation of the scenario calculation dated 31 October 2008. Therefore, the minimum solvency requirements continued to be more than met, by a considerable margin, at the balance sheet date of 31 December 2008. Nevertheless, the global financial crisis caused the coverage ratio for solvency to fall from 207% in the previous year to an estimated figure of 182% in the year under review.

### Health insurers

Health insurers, too, are set to meet the solvency requirements according to the scenario calculation forecast. At 224%, the coverage ratio for the solvency target in the sector was unchanged from the previous year. Therefore, despite the capital market crisis, the amount of own funds available to the sector was good.

### Property and casualty insurers

In the area of property and casualty insurance, the coverage ratio in 2007 increased yet again, up from 303% to 318%. It is thus at a level which is significantly higher than the minimum capital requirements. This situation came about due to the lower solvency margin which resulted from a downturn on the one hand and from an increase in own funds on the other. The latter was up thanks to the injection of fresh capital by the partners and through the reinvestment of profits. This is a reflection of the positive earnings situation enjoyed by property and casualty insurers in the last financial year.

### Reinsurers

The coverage ratio for the reinsurers subject to supervision in Germany was highly satisfactory in 2007. The amount of solvency capital required by the supervisory authority amounted to €6.3 billion, whilst own funds totalled €66.9 billion. The coverage ratio was thus approximately 1,100%. The reason for this high level of own funds is a specific one relating to Germany, where a few major reinsurers also act as holding companies for an insurance group or a financial conglomerate. Thus the own funds available to these companies is not only used to cover reinsurance activities but is also necessary for financing their function as a holding company. Excluding the holding companies from the calculations would result in own funds of €13.8 billion, with the solvency margin amounting to €5.4 billion. This would represent a coverage ratio of 258%.

### Pensionskassen

According to forecasts, the coverage ratio for the solvability target for Pensionskassen stood at approximately 117% at the end of 2008, lower than the previous year's value. This was caused in particular by the situation on the financial markets, which led to the undertakings generating less capital earnings or having to make write-downs, which had an effect on regulatory capital. Three Pensionskassen made use of the transition period to ensure complete coverage of the solvency margin by 31 December 2009. According to estimates as at 31 December 2008 the own funds of eight further Pensionskassen was below the solvency target for a variety of reasons. Measures for eliminating this shortfall were worked out in consultation with these undertakings. These included transferring funds from sponsoring companies or drafting a solvency plan.

### Pension funds

In the case of virtually all of the 27 pension funds, the minimum amount of own funds required equalled the minimum amount of the guarantee fund. Overall, the provision with eligible and unencumbered own funds remained stable. One pension fund increased its own funds in the year under review.

## 2.4 Stress testing

BaFin conducted a stress test for 2008 as at the balance sheet date of 31 December 2007. The stress test scenarios applied to date remained largely unchanged. The supervisory authority only modified the combined shares and real estate scenario, adapting it to current developments. This was done in light of the fact that the insurers are permitted to use shares in a REIT public limited company as tied assets by allocating them to the real estate quota. For this scenario, BaFin retained the deduction of 20% that it had adopted for shares. The deduction for real estate, however, was increased from 8% to 10%.

Furthermore, in the stress test for life insurance undertakings and Pensionskassen, BaFin took into account the policyholders' participation in the valuation reserves as prescribed by law.

BaFin included 99 life insurers in the evaluation. Three undertakings were exempt from stress testing due to the low risk of their investments. With the exception of one relatively small undertaking, which recorded a slightly negative result in one scenario, all life insurers achieved positive results in the four scenarios.

● One life insurer,...

● ... one health insurer,...

As regards the health insurers, BaFin included 44 such undertakings in the evaluation, with the remaining seven undertakings exempt from the obligation to submit their test results due to the low risk of their investments. One health insurer recorded negative results in the stress test. This undertaking has introduced measures to restore risk-bearing capacity. As far as all the other undertakings were concerned, even in the event of significant price falls or interest rate rises, it was sufficiently certain that enough assets would have been in place to match the actuarial reserves and statutory regulatory capital requirements.

● ... seven property and casualty insurers,...

BaFin requested that 186 property and casualty insurers submit their stress test results, whilst 41 undertakings were exempt from this requirement.

179 property and casualty undertakings reported positive stress test results. Five undertakings recorded negative results in all four scenarios, one insurer recorded a negative result in three scenarios and one insurer in one scenario.

The main reason for this was the increased extrapolation of the target values stipulated by the stress test model. Triggered by strong corporate growth, lower premiums and the restructuring of reinsurance business, there was an above-average rise in the liabilities to be covered, particularly provisions for claims that had not yet been settled. Nevertheless, even in the case of the undertakings with negative stress test results, it can be assumed – based on the current circumstances – that risk-bearing capacity is adequate.

● ... and eight Pensionskassen reported negative stress test results.

Of the 152 Pensionskassen supervised by BaFin at the end of 2007, 26 were not required to submit stress test results due to their investments showing no or only negligible risks. 118 of the 126 Pensionskassen with a reporting requirement recorded positive results in all four stress test scenarios. As far as the eight Pensionskassen with negative results were concerned, the shortfall was generally small in each case. Over the course of 2008, these undertakings adopted measures to restore risk-bearing capacity.

## 2.5 Composition of the risk asset ratio

All primary insurance undertakings reported on their investment portfolio in its entirety as at the reporting date of 31 December 2008. The undertakings were required to provide a breakdown of the different classes of investments in accordance with the schedule of investments listed in the Investment Ordinance (Anlageverordnung – AnIV) and on the basis of their particular risks.<sup>7</sup>

The following evaluations are based on the data for life, health and property/casualty insurance undertakings as well as Pensionskassen. The book value of all the investments held by

<sup>7</sup> Section 2 (1) AnIV; Documentation 670.

these insurance classes totalled €1.08 trillion at the time of reporting, after €1.09 trillion in the previous year.

Insurance undertakings may invest 35% of their restricted assets in investments involving a higher level of risk. In addition to equity-based investments in particular, these investments include participatory rights, claims from subordinated liabilities and hedge funds.

Table 7  
**Investments 2008**

Form of investment in accordance with section 2 (1) No.... AnIV, version dated 21.12.2007	Restricted Assets									
	Life insurers		Health insurers		Property and casualty insurers		Pensionskassen		Total for all four classes	
	Absolute in € million	Share	Absolute in € million	Share	Absolute in € million	Share	Absolute in € million	Share	Absolute in € million	Share
Total investments*	669,077	100.0%	149,983	100.0%	116,394	100.0%	103,651	100.0%	1,039,105	100,0%
Thereof:										
Loans against securities (No. 2), provided that shares (No. 12) are the object of the loan	0	0.0%	0	0.0%	0	0.0%	0	0.0%	0	0.0%
Receivables from subordinated debt and participation rights (No. 9)	19,857	3.0%	5,685	3.8%	3,282	2.8%	2,164	2.1%	30,988	3.0%
Fully paid-up shares which are included in a regulated market (No. 12)	6,786	1.0%	523	0.3%	835	0.7%	41	0.0%	8,185	0.8%
Non-listed fully paid-up shares, participating interests in a limited liability company, limited partnership and participating interests as silent partners within the meaning of the Commercial Code (No. 13)	10,570	1.6%	2,080	1.4%	1,940	1.7%	447	0.4%	15,037	1.4%
Units in funds (No. 15-17, incl. hedge funds), provided that they include – fully paid-up shares and participation rights which are included in a regulated market in the EEA	25,157	3.8%	3,486	2.3%	7,405	6.4%	6,872	6.6%	42,920	4.1%
– cannot be definitely allocated to another form of investment; residual fund value and non-transparent funds	13,926	2.1%	1,918	1.3%	2,835	2.4%	2,736	2.6%	21,415	2.1%
Investments in high-yield bonds	6,248	0.9%	618	0.4%	755	0.6%	376	0.4%	7,997	0.8%
Increased market risk potential of funds**	3,366	0.5%	246	0.2%	1,045	0.9%	185	0.2%	4,842	0.5%
Investments linked to hedge funds (partly in categories other than the numbers of AnIV set out above)***	2,945	0.4%	642	0.4%	399	0.3%	709	0.7%	4,695	0.5%
Total investments subject to the 35% risk capital ratio	88,855	13.3%	15,198	10.1%	18,496	15.9%	13,530	13.1%	136,079	13.1%

\* charges and capital annuity charges.

\*\* This is the MRP exceeding 100%, which must be added to section 3 (3) sentence 1 AnIV.

\*\*\* Approximate values.

Source: Sector totals as at 31 December 2008 for life, health and property/casualty insurers as well as Pensionskassen from documentation 670 and 673, Circular 11/2005 (VA)



● In terms of the sector average, equities stood at 4.9%.

All fund investments not attributable to other types of investment were included in the so-called residual value, which accounted for 2.1% of the restricted assets for all classes. Non-transparent funds were also allocated in full to this residual value. The residual value ranged between 1.3% for health insurers and 2.6% for Pensionskassen.

Not taking into account the residual value, undertakings' equity-related investments accounted for an average of 4.9% of restricted assets, down markedly from the previous year's value of 8.6%. Across the different insurance classes, this ratio ranges from 2.6% for health insurers to 7.1% for property and casualty insurers.

The risk asset ratio also includes investments in hedge funds or other direct or indirect investments linked to hedge funds. Direct investments in hedge funds are included in the fund unit investment class to a minimal extent. Most hedge funds investments, however, constitute note loans from suitable credit institutions or bonds whose yields and/or redemption value is dependent on a hedge fund or hedge fund index. These are allocated to the schedule of investments in accordance with their cash instrument. Pursuant to section 3 (3) AnIV, however, they must also be fully included in the risk asset ratio. These investments account for 0.5% of the risk asset ratio.



Subject to certain conditions, insurance undertakings may invest up to 5% of their restricted assets in high-yield investments. These investments, which account for 0.8% of the restricted assets, are also included in the 35% ratio.

In accordance with the Investment Act, a fund may, through the use of specific derivatives or the corresponding provisions of another state, leverage potential market risk. This increased potential market risk of a fund is counted towards the risk asset ratio in accordance with the AnIV.

Table 8  
**Proportion of total investments  
 in selected asset classes**

Form of investment	Total assets									
	Life insurers		Health insurers		Property and casualty insurers		Pensionskassen		Total for all four classes	
	Absolute in € million	Share	Absolute in € million	Share	Absolute in € million	Share	Absolute in € million	Share	Absolute in € million	Share
Total investments*	689,147	100.0%	152,508	100.0%	136,891	100.0%	104,188	100.0%	1,082,734	100.0%
Thereof:										
Investments in private equity holdings (in restricted assets according to section 2 1 No. 13 AnIV)	4,187	0.6%	782	0,5%	782	0.6%	208	0.2%	5,959	0.6%
Directly held asset backed securities and credit linked notes according to C 1/2002	4,913	0.7%	536	0,4%	579	0.4%	566	0.5%	6,594	0.6%
Asset backed securities and credit linked notes held in funds according to C 1/2002	6,083	0.9%	1,053	0.7%	1,980	1.4%	699	0.7%	9,815	0.9%
Investments in hedge funds and in investments tied to hedge funds (in restricted assets according to C 7/2004)	3,599	0.5%	683	0.4%	591	0.4%	914	0.9%	5,787	0.5%

\* Including cash at credit institutions, excluding liabilities from mortgages, land charges and capital annuity charges.

Source: Sector totals as at 31 December 2008 for life, health and property/casualty insurers as well as Pensionskassen from documentation 670 and documentation 673, Circular 11/2005 (VA)

As was the case previously, only a small proportion of investments is attributable to alternative investments.

The table shows that the level represented by alternative investment classes as a proportion of total investments is virtually unchanged from the previous year. Only the share of private equity investments rose, from 0.4% to 0.6%.

## 2.6 Risk-oriented supervision

In anticipation of Solvency II, BaFin is already adopting a more risk-oriented approach to supervision. Among other things, an important milestone was the new requirement laid down in the VAG for the comprehensive implementation of a suitable risk management system. This thus anticipates the European specifications for a new qualitative and quantitative supervision of solvency.

From a personnel point of view, BaFin's increased orientation towards a risk-based approach entailed the appointment of additional members of staff in this area. During 2008, BaFin was able to fill approximately half of the 30 established vacant positions.

### Internal Models Working Group (IMWG)

● Preparation for auditing Internal Models.

Under the terms of Solvency II, insurers will have access to two risk-based methods for proving compliance with the supervisory own-fund requirements. Alongside the standard approach, in future insurers will also be able to calculate the own funds required with the help of an "Internal Model" approved by BaFin.

The Working Group Internal Models (WGIM), set up in 2006, offers an opportunity to discuss these Internal Models with interested company representatives. This working group also held two rounds of discussions in 2008, which focused on the use of "vendor models", models offered by external providers. The insurers expressed great interest in the idea of purchasing from external providers those parts of an Internal Model that they could not or did not wish to develop themselves.

In the autumn, BaFin also carried out a survey of the insurers via the working group in order to determine the status of development of the planned Internal Models. Of the 22 insurers which replied, five declared that they already considered themselves to be in a position to seek certification. A further five insurers are looking to introduce an Internal Model in principle and have started the project phase. As matters stand, the remaining twelve insurers will implement the standard methods, albeit applying internal parameters.

### Risk classification

● BaFin classified insurers into risk classes.

BaFin assigns the undertakings under its supervision to risk classes, with a view, among other things, of determining the intensity of supervision.

The first aspect of an insurer that is considered when assigning it to the risk matrix is the impact of the undertaking in the market, i.e. its systemic relevance. BaFin determines the systemic relevance of property and casualty insurers and reinsurers based on their gross premium income. For all other insurers, and for pension funds, the decisive factor is the level of their total investments. Systemic relevance is categorised as high, medium or low.

The second criterion is the quality of the undertaking, worked out with reference to the following sub-areas, each of which is evaluated and scored: "asset, financial and income situation, growth" and "quality of management". The scores awarded to each sub-area are based on key figures specific to the insurance industry or on qualitative criteria. The evaluation system combines the sub-area scores in order to arrive at an overall score, which is then transferred to a four-level scale from A (high) to D (low).

BaFin last carried out such a risk-classification process for insurers in December 2008.

Table 9

**Results of the 2008 risk classification**

Undertakings in %		Quality of the undertaking				Total*
		A	B	C	D	
Systemic relevance	High	1.1 %	6.5 %	1.6 %	0.0 %	9.2 %
	Medium	3.5 %	13.0 %	3.0 %	0.3 %	19.8 %
	Low	12.2 %	43.1 %	13.8 %	1.9 %	71.0 %
Total*		16.8 %	62.6 %	18.4 %	2.2 %	100.0 %

\* Rounding differences may cause discrepancies in the digits after the decimal points.

As in the previous year, BaFin did not rate any insurer with a high market significance as "low" in the "quality" criterion. There was a heavy concentration of undertakings in the fields indicating "low systemic relevance" and medium or high quality. This was accounted for by 55.3% of all undertakings.

● Number of good quality insurers fell.

Tracing the development of insurers' quality since 2007, the proportion of undertakings rated "very good" has remained constant at around 19.5%. In contrast, the number of companies of "good quality" was down, whilst the proportion of undertakings awarded a score of C or D continued to rise. The reason for this is likely to be the financial crisis which was gradually taking hold in 2007, even though it is likely that the full impact of the crisis will not become apparent until 2009.

● There were significant differences between individual classes.

Nevertheless, there are significant differences between the individual classes in terms of the nature and extent of the change: there was a shift in quality from B to C of approximately 8-9% for life insurance undertakings and a shift of similar proportions – this time from A to C – for the corresponding criterion for death benefits funds. Only one life insurer was rated "low" for the "quality" criterion during the observation period; however, it has since been possible to remedy the problems causing this low rating.

There was a similar situation for reinsurers and property and casualty insurers, which, with around 270 companies, account for approximately 42% of the insurers supervised by BaFin. The percentage of insurers whose quality was rated "very high" thus fell from 16% to 10%, whilst the percentage of undertakings given a score of C increased by 4.5% over the same period. At an average of 0.5%, undertakings whose quality was rated "low" play only a minor role.

For pension funds, the number of funds whose quality was rated “very high” has continued to rise since 2007, whilst the number of undertakings given “only” a score of B has declined to the same extent. This points to a general improvement in the level of quality. To date, BaFin has only awarded a score of C to one fund, whilst no overall score of D has been given. Numerically speaking, the pension funds class is dominated by the “very good” undertakings. In this respect, the pension funds differ from all other classes, in which “B” is by far the most common score. The fact that the first pension funds in Germany did not start up business until 2002, however, puts these results into perspective.

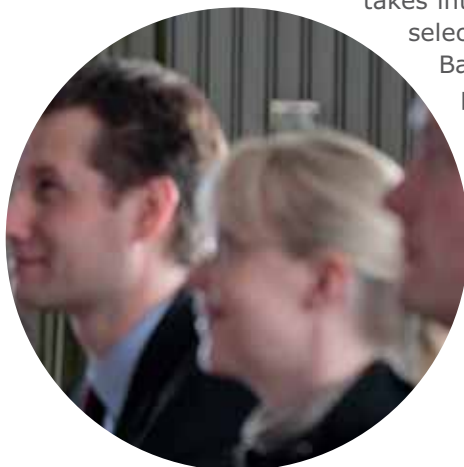
An improvement in quality could also be observed with the Pensionskassen. However, the shift from B to A was only approximately 4%, whilst the proportion of undertakings awarded a score of C or below remained stable at 20%. Similarly, health insurers have also seen an improvement since 2007, although this was not the case with either the very good or the poor undertakings. The scale of the increase was unusual: whereas the beginning of 2007 saw 35% awarded a score of C, the proportion at the end of the year was only just over 15%. At the same time, the proportion of insurers awarded a score of B rose from 52% to 71% over the same period.

● No changes in terms of systemic relevance.

The past two years have not seen any notable changes in terms of the systemic relevance of the insurance undertakings. Although BaFin has raised or lowered individual insurers’ scores, this only applied to companies whose level of investments or premium income was borderline. The proportion of these changes has proved to be statistically irrelevant.

### On-site inspections

BaFin incorporates findings from the risk classification process into its supervision plans for insurers and Pensionskassen in that it takes into account the risk classification results when selecting its on-site inspections. For 2008, therefore, BaFin prioritised audits at insurers with a high risk potential that had not recently been audited. In the year under review, the total number of on-site inspections stood at 58.



The following risk matrix shows the distribution of audits by risk class.

Table 10

### Distribution by risk class of on-site inspections in 2008

Companies in %		Quality of the company				Total	Companies in %
		A	B	C	D		
Systemic relevance	High	2	5	0	0	7	12.07 %
	Medium	4	8	1	0	13	22.41 %
	Low	8	20	7	3	38	65.52 %
Total		14	33	8	3	58	100.00 %
Companies in %		24.14 %	56.90 %	13.79 %	5.17 %	100.00 %	

## 2.7 Risk and audit reports

Since January 2008 – in anticipation of Solvency II – the VAG has demanded the comprehensive implementation of an appropriate risk management system for insurers.<sup>8</sup> The new duties include, most notably, the drafting of risk and audit reports to company management. These are also to be presented to BaFin.

Since the implementation of these regulations represents a considerable burden for smaller companies, in particular, BaFin has granted all insurers a transition period for 2008. This means that they will not be required to submit the reports until 2009. However, the companies were given the option of submitting their reports to BaFin as early as 2008.

### 2.7.1 Risk reports

In the year under review, 47 insurers voluntarily submitted risk reports to BaFin. This equated to 7.4% of all insurers subject to supervision by BaFin. The majority of these reports were from companies whose relevance to the system is classified as low by BaFin. However, they also included a number of medium-sized companies and two major insurance groups.

<sup>8</sup> 2007 Annual Report, p. 75.

With regard to the branches covered, property and casualty insurers and life insurers were disproportionately heavily represented, at 11.4% and 10.1% respectively, while health insurers, pension funds and Pensionskassen were under-represented. In 2008, BaFin did not receive any risk reports from reinsurers or death benefits funds.

The following table provides an overview of the risk reports submitted.

Table 11

### Risk reports

Class	Number	Share of Risk reports	class coverage
Property and casualty insurers	25	53.2%	11.4%
Life insurers	10	21.3%	10.1%
Pensionskassen	8	17.0%	5.2%
Health insurers	3	6.4%	5.9%
Pension funds	1	2.1%	3.7%
Death benefits funds	0	0.0%	0.0%
Reinsurers	0	0.0%	0.0%
<b>Total</b>	<b>47</b>	<b>100.0%</b>	<b>7.4%</b>

### General information

A risk report should contain meaningful reporting to the company's management. It should include the main aims of risk management, the methods for assessing risk and the actions taken to limit risk. In addition, it should show the effect of the measures to limit risk and how the aims are achieved and managed.

Reports may appear on a rotational basis, ranging from once a month to once a year. Shorter cycles have the advantage of being able to show changes in the risk situation more rapidly. Reports providing information over a longer period are normally more comprehensive and more detailed. However, the reaction they envisage is less urgent. Most of the risk reports submitted appear quarterly, which represents a compromise between accuracy and being up-to-date.

The reports submitted to BaFin by insurers differed markedly in scope and quality. Some insurers were content with listing a few key figures, with almost all of which BaFin was already familiar from annual and quarterly reports. Others submitted reports of over 50 pages, detailing every identified risk. Although a general inference on the quality of the report is not permissible based on its scope, it was evident that it is not easy to communicate risk efficiently in very short reports.

Reports differed markedly in their selection of the risks mentioned. Most reports concentrated only on the most important risks and on changes to risk classifications over time. Only a few individual risks were listed explicitly here.

Other reports listed the ten to 25 largest risks. Some reports in this group sub-divided risk into several sub-groups, as envisaged in the draft of MaRisk (VA), and specified the five largest risks for each individual category. Reports in this class were typically somewhat more comprehensive.

● Scope of the risk reports submitted varied greatly.

● The majority of reports contained a risk matrix.

A few reports provided detailed overviews, the majority in a tabular format, of all of the risks identified in the company. This reports in this group tended to be more comprehensive and were often less accessible than the other two types of report.

Risks are shown with the likelihood of their occurring and the anticipated amount of loss. The majority of risk reports submitted to BaFin took account of both factors in the form of a risk matrix. These reports categorised – in accordance with their specification in the respective risk management process – each of the two influencing factors into three to five sub-categories from “low” to “high”.

The classification of the amount of loss, in particular, was frequently incomprehensible in the reports and was therefore difficult to verify since as a rule the reports contained no information as to how the disclosures had been derived. Only a few reports referred to concrete values such as regulatory capital. The remaining reports only cited the threshold amounts.

The reports assigned levels of risk potential to risks based on their position in the risk matrix, which ranged from minor threats to those that threatened companies’ existence.

Insurers, who did not use a risk matrix in their reports, preferred to manage their risk with time sequences of market prices, ratings, available own funds and stress scenarios.

The two major insurance groups adopted a different approach: at management board level, they do not manage the individual risk categories and business segments according to individual risks, but as a whole. In so doing, they use specific key figures such as risk capital, (European) embedded value or RoRAC (return on risk adjusted capital). In their reports, the groups itemised these key figures according to their composition. Diversification effects were also applied here.

### **Sector evaluation<sup>9</sup>**

The small number of risk reports submitted voluntarily meant that an initial sector evaluation was only possible for the life insurance and property and casualty insurance segments. Incidentally, since many reports referred to 2007, the current financial crisis had not yet been reflected in the reports.

<sup>9</sup> Risk reports, which do not include a risk matrix, were not taken into account.



● Life insurers viewed market risks as the greatest threat.

According to their risk reports, life insurers viewed ALM (asset liability management) and market risks as the greatest danger. The ALM risk relates to the dangers resulting from differing maturities and changes in assets and liabilities. The majority of life insurers classified this risk as high and the remainder as average. Two companies even judged this risk as posing a threat to their continued existence.

Frequently, reports also mentioned biometric risks, namely death, survival and invalidity. Life insurers classified survival risk as high in view of rising life expectancy.

There was an obvious trend towards default risk in the reports. Some life insurers classified this risk as low on account of their having comprehensive hedging measures in place, while others considered it high because long terms for insurance policies are inherent in the system.

In the area of operational risk, reports mentioned in particular legal risks and IT risks. Insurers viewed the risk situation for legal risks as average, since changes to the law or case law may affect provisions and surplus bonuses.

IT risks focused on IT failures as well as data protection and security. Failure of important IT systems was considered as an average risk. Life insurers assigned a higher risk potential to the issue of data security and data protection.

● Property/casualty insurers ascribed the greatest potential risk to rate-setting.

According to the risk reports received by BaFin, property and casualty insurers viewed actual setting of rates as the greatest risk. Insurers assign an average to high risk potential to this risk, since, unlike most other segments, the setting of rates offers the opportunity to exercise far more discretion. However, this carries the risk of misjudgments and miscalculations. Passive reinsurance risks are closely associated with rate-setting; they tend to be classified as average. The same is true of major and accumulated losses.

Although property and casualty insurers are also exposed to the risk of interest rate and price changes, they classify market risk as average. This is because they have to generate practically no guaranteed rate of interest.

Property and casualty insurers' risk reports also looked at personnel risks. These related primarily to dependence on key personnel, whose departure would cause considerable disruption to internal operations and the risk of an ageing workforce.

### 2.7.2 Audit reports

In 2008, BaFin received 53 audit reports in total. Insurance groups often submitted their reports for the entire group, which meant that a total of 66 individual companies were affected. Unlike for the risk reports, a substantial proportion were sent by medium-sized and large companies while smaller companies were somewhat under-represented. While almost all larger companies have had an internal audit function in place for a number of years, the audit procedure now also applies to small companies employing only a few staff.

#### General information

The audit report shows the key findings from checks carried out by the internal audit function for the past financial year and the issues that will be examined during the current financial year. It usually consists of several elements.

It starts with a precise description of the audit assignment. This will include the department or branch affected, the object of the audit and the duration of the investigation. This part of the report is frequently in tabular form.

The audit procedures and findings are subsequently listed. There were considerable differences in these listings among the audit reports submitted. Some reports only listed the most important findings, i.e. problems, which have to be rectified in the immediate future. This led to some companies not reporting any incidents. By contrast, other insurers reported all of their findings classified according to severity. Positive anomalies only featured in a very small number of reports. Findings were presented in tabular form in most reports. Only a few reports contained comments on the measures adopted to follow up any shortcomings that had been identified.

The final element that is generally common to all reports is planning for the subsequent year. Apart from new audit assignments, all uncompleted procedures from the past year are listed here.

#### Typical anomalies

As expected, the audit reports showed shortcomings in many places. The table below lists auditors' ten most common complaints:

Table 12

**Violations in the audit reports**

No.	Evidence (degree of severity not taken into account) affected	Number of insurers affected
1	Insufficient documentation	41
2	IT security	33
3	IT user rights	20
4	ICS	17
5	Risk reporting/risk management	16
6	Division of functions	14
7-9	Violations/abuse of powers of attorney	11
7-9	Outsourcing	11
7-9	Processes, documentation, etc. not sufficiently up-to-date	11
10	Fraud	7

The fact that the issue of “documentation” was first on the list was not surprising. In every company, there are processes, working instructions and similar procedures that are not documented sufficiently.

## 2.8 Developments in the individual sectors<sup>10</sup>

### Life insurers

● Global financial crisis causing problems for life insurers.

The life insurers supervised by BaFin recorded gross premiums in direct insurance business of some €75.3 billion in 2008. This equates to growth on the previous year of some 0.6%. The investment portfolio shrank by approximately 1.1% to roughly €690 billion.

In the year under review, the life insurers’ economic situation remained stable even though the global financial crisis had a significant impact. On the one hand, the drastic fall in stock prices caused problems. On the other hand, as a consequence of the general loss of confidence on financial markets, the substantial risk premiums for fixed-income securities issued by private sector debtors had an adverse effect. By contrast, the sharp fall in the current yield on public sector bonds impacted favourably on valuation reserves.

According to provisional disclosures, the sector had hidden reserves in all investments of some €10.4 billion at the year-end. This equates to approximately 1.5% of all investments.

● All life insurers coped with the various forecasts.

In the year under review, BaFin carried out two scenario-based assessments of the life insurers for the cut-off dates of 30 June and 31 October. Alongside BaFin’s stress testing process, the scenario-based assessments provide an additional risk-based supervisory instrument. They simulate the impact on commercial success of negative developments on the capital market.

<sup>10</sup> The figures for 2008 are therefore only provisional. They are based on interim reporting as at 31 December 2008 and on forecasts.

In setting the conditions for the scenario-based assessments, BaFin took account of the changes in stock prices that had already occurred in the current year. The sudden falls in prices in 2008 were therefore taken into account to an appropriate degree by a corresponding easing of the scenario guidelines. The scenarios for stock prices moved within a range of up to 15% below the equity price at the given time. BaFin refrained from carrying out an assessment based on interest rates for the cut-off date of 31 October. Instead it set an additional equity-based scenario.

The findings of the scenario-based assessment indicated that all life insurers would have been in a position to fulfill their commitments even in the event of unfavourable scenarios occurring.

Net return stood at only 3.4%.

The average net return on investments in 2008, based on provisional disclosures, stood at 3.4%, which is well down on the level of previous years. The low figure is the result of substantial extraordinary write-downs as a consequence of the global financial crisis.

In its second scenario-based assessment, BaFin requested information on surplus bonuses for 2009. Considered overall, the surplus declaration was slightly down on the level of the previous year. The arithmetic average of total surpluses declared for endowment policies for 2009 amounted to 4.2% (previous year: 4.3%).

New version of the sample business plan for surplus bonuses.

In September 2008, as a result of intensive discussions between the German Insurance Association (GDV – Gesamtverband der Deutschen Versicherungswirtschaft), companies and BaFin, the latter published a fundamentally revised sample of an overall business plan for surplus bonuses (sample business plan).<sup>11</sup> It was preceded by two consultation processes.

### Sample business plan

Sample business plans give life insurers guidance on how their business plans should be structured. They also specify the levels of detail of regulations which the plans should contain. As a result, they support life insurers in undergoing the supervisory approval process. Since the samples only act as examples and are, in principle, not compulsory, each business plan submitted must be scrutinised on a case by case basis in practice. Approved business plans relate solely to existing policies, i.e. insurance policies which, with a few exceptions, were taken out up until the end of 1994. By contrast, for new policies, insurance policy issues are solely a civil law matter; supervisory approval is not required there.

Revision of the sample business plan because of the new system for participating in the valuation reserves.

The revision was needed as a consequence of the reform of the Insurance Contract Law (Versicherungsvertragsgesetz – VVG), in particular, because of the newly introduced right on the part of

<sup>11</sup> Circular 10/2008 (VA).

<sup>12</sup> 2007 Annual Report, p. 76 f.

customers to share in the valuation reserves.<sup>12</sup> Since the beginning of 2008, all contracts carrying a right to surplus bonuses are legally entitled to a share of this kind. As a rule, section 153 VVG demands that a cause-oriented approach be adopted here. Two approaches of this kind are described as examples in the new sample business plan. In addition – as a result of the new Minimum Funding Ordinance (Mindestzuführungsverordnung) – BaFin amended its requirements for the allocation to provisions for the reimbursement of premiums and updated the regulations concerning final surplus bonuses. Companies have adjusted their business plans accordingly and submitted them to BaFin for approval.

### Private health insurance

● Growth in premiums falls to around 3%.

According to provisional figures, the 51 private health insurers subject to supervision by BaFin generated total premium income of around €30.3 billion in 2008. This equates to a year-on-year increase of approximately 3%. Due to the ongoing debate on reform of the healthcare system, the market for private health insurance remained challenging. In relation to full medical costs insurance especially, only low levels of new business were recorded. As a result, a large proportion of the growth in premiums was attributable to the adjustment of premiums.

● Financial markets crisis is depressing health insurers' income and reserve situation.

Life insurers increased their investment portfolio sharply by 7% to approximately €152 billion in 2008. Nevertheless, the year under review was dominated by the financial crisis and resultant sharp falls in stock prices on equity markets. The distortions in prices had an adverse effect on health insurers' income situation. BaFin is expecting more substantial write-downs on investments. However, the sharp fall in interest rates in 2008 had a positive impact on companies' reserves. At the end of 2007, balanced hidden reserves in investments amounted to €1.2 billion and rose to €3.3 billion in 2008.

● All of the health insurers are in a position to cope with the various different scenario-based assessments envisaged by BaFin.

The current yields on public sector bonds fluctuated considerably in 2008 and fell by approximately 1.4% to around 2.9% by the end of December. This reduction in capital market interest rates may also adversely affect the income situation of health insurers in the medium to long term. The technical interest rate currently used by almost all health insurers is above the interest rate achievable on new secure investments, at 3.5%. Should this be the start of a longer period of low interest rates, companies may be forced to accept additional credit rating and market risks solely to achieve the technical interest rate of 3.5%.

While the technical interest rate can be reduced within the space of a few years via premium adjustments in health insurance, this leads to higher premiums for new and existing business. BaFin therefore views the trend in falling interest rates critically in the medium to long term and this is despite the effect that in the case of investments that are repaid at nominal value on final maturity, reserves may be created temporarily if interest rates fall.

● Net interest earned expected to be below 4% in 2008.

● Launch campaign for the modified standard rate.

● Extension of the launch campaign.

BaFin required 40 health insurers to carry out scenario-based assessments on the cut-off dates of 30 June and 31 October 2008 and to submit their results. Eleven companies were exempt from the requirement to submit results due to the low-risk nature of their investments, or due to the fact that their health insurance business was carried out in the same manner as property insurance. All of the health insurers were in a position to cope economically with the various different scenarios.

The scenario-based assessments indicate that the financial markets crisis will depress income from investments significantly. BaFin therefore assumes that the companies in question achieved a level of net interest earned of below 4% in 2008. Nevertheless, all of the health insurers were able to fulfil their guaranteed rate obligations in all three scenarios. However, a few health insurers were unable to finance the technical interest rate for the mathematical provisions solely from investment income. This is because of the sharp rise in write-downs and lower write-ups or gains on the disposal of investments. However, the companies affected had sufficient other surplus funds, such as the safety loading, at their disposal to guarantee the requisite allocation to the ageing reserves.

Since 1 July 2007, persons who have lost their private health insurance or who have never been insured and who should be allocated to private health insurance in view of their professional biography have been able to demand insurance cover at the modified standard rate.<sup>13</sup> The GKV-WSG envisaged compulsory acceptance for private health insurers, forbade the agreement of risk premiums and exclusions and limited premiums to the statutory health insurance scheme's average maximum premium.

With a limited launch campaign running until 31 December 2007, health insurers aimed to offer those persons who were not insured but were entitled to cover an incentive to return to private health insurance as soon as possible: after a specific waiting period, health insurers also refunded the ongoing treatment costs of those uninsured people having opted for cover at the modified standard rate. The companies also waived risk premiums and exclusions on private obligatory nursing care insurance and limited holders' premiums to the maximum amount under social nursing care insurance. However, for policies taken out after 31 December 2007, ongoing treatment costs should no longer be refunded under health insurance and risk-adequate premiums should be collected under obligatory nursing care insurance.

However, at the instigation of BaFin and following consultation with the Federal Ministries of Finance, Justice and Health, the private health insurers agreed at the start of 2008 to continue the launch campaign, which had expired at the end of 2007, without any changes in terms of content until 31 December 2008.

<sup>13</sup> 2007 Annual Report, p. 101.

- Flat rate risk premium in the event of switching rates.

At the start of 2009, the basic rate replaced the previous modified standard rate. The insurers converted insurance policies taken out under the modified standard rate to basic rate policies.

Under the VVG, in the event of an existing insurance contract, a policyholder can demand that his insurer include the rights acquired under the contract and ageing reserves when accepting applications to switch to different rates with the same insurance cover.

In the year under review, one health insurer demanded a flat rate risk premiums from those policyholders, who wished to change from old rates to a new rate scheme. This led to the fact that policyholders should pay more or less the same premium for the same benefits as before the rate change. The company justified this flat rate risk premium on the grounds that the new rates differed from the old rates in the risk assessment and premium calculation in particular. The flat rate risk premium would serve to offset the difference in the premium, which would result from the different calculation approaches and/or the more stringent risk assessment under the new rates.



BaFin doubted the legality of this flat rate risk premium in certain circumstances. It therefore objected to the collection of the rate structure premium if no risk-increasing circumstances, which would lead to a risk premium under the acceptance principles for the new rates, were documented when the policy was taken out.

Although the Federal Administrative Court had established in a ruling<sup>14</sup> that, when switching rates, a policyholder does not acquire the right to exemption from risk premiums under a rate that is calculated in a completely different manner. At the same time, however, the Court had also decided that a risk classification undertaken by the insurer in the initial rate counts as one of the acquired rights to be included in the event of a rate switch. The policyholder's state of health may not be reassessed subsequently. The company appealed against BaFin's prohibition order.

### Property and casualty insurance

In 2008, property and casualty insurers reported satisfactory business development. The reduction in claim expenses compared with the previous year impacted positively on results. Although two significant natural disasters were also recorded in 2008 in the form of hurricane Emma in March and the hail storm Hilal in June, claims were well down on the previous year. Insurers were worse affected by hurricane Kyrill in 2007.

Traditionally, motor vehicle insurance exerts a significant influence on the trend in property and casualty insurers' premiums. The

<sup>14</sup> Judgement of 05.03.1999, Ref. 1 A 1.97, BVerwGE (Fed. Constitutional Court) 108, 325.

picture here was characterised by a fall in premium income caused by more intense competition. By contrast, property insurance recorded a rise in premium income. As a result, premium income stagnated more or less at the level of the previous year.

The estimated combined ratio for direct insurance business fell from 93% to 90% compared with the previous year. This resulted in a higher technical profit year on year.

### Reinsurance

The 2008 financial year was characterised by a number of natural disasters, which caused macroeconomic losses worldwide of approximately €144 billion (previous year: €52 billion). Insured losses totalled around €32 billion (previous year: €21 billion) and were largely attributable to hurricanes Gustav and Ike. The largest damage event in Germany was the winter storm Emma, which caused insured losses amounting to €1.1 billion. Provisional estimates for the sector assume gross premiums for German reinsurers of just under €38 billion for 2008, while own funds are estimated to come to just under €69 billion.

### Pensionskassen

Following a slight decline in the previous year, the premium income of the Pensionskassen again rose slightly – according to forecasts – in the 2008 financial year. By and large, the insignificant rates of change of recent years show that the market for the new competitive Pensionskassen established since 2002 is largely saturated. In the case of Pensionskassen, which are predominantly financed by employers, the development of premium income depends on staff levels at the sponsoring company. Here, premium income fluctuates in line with changes in staff levels.

The investments held by the 153 Pensionskassen supervised by BaFin rose by around 5% to some €104 billion in 2008.

In addition to the investment risks accounted for by stress testing and the forecasts, Pensionskassen also face what is known as the insured party's longevity risk. This may also lead to Pensionskassen having to adjust their bases of calculation and increase their mathematical provisions over the next few years. The capital market crisis made it more difficult for companies to generate the surpluses needed to finance these adjustments in the financial year.

As in previous years, BaFin made forecasts for the Pensionskassen as at 30 June 2008, in which the operating result had to be forecast against four stocks and interest rate scenarios. Because of the particular situation on capital markets, BaFin also asked 139 Pensionskassen to submit forecasts for three scenarios looking solely at stock prices as at 31 October 2008 for the first time. 14 companies were exempt from submission because of the low-risk nature of their investments. The findings of these forecasts showed

● Premium income rose slightly.

● Forecast showed the deterioration in the income situation of the Pensionskassen.



that the income situation of Pensionskassen deteriorated in 2008. Around 30% of Pensionskassen intend to use section 341b HGB on the balance sheet date and refrain from writing down investments held as fixed assets. The forecasts also already indicate that some Pensionskassen will fall short of the solvency margin for a variety of reasons. Among other things, contributions by sponsoring companies, the submission of solvency plans or portfolio transfers are envisaged for these Pensionskassen.

### Pension funds

At the 2008 year-end, the number of people receiving benefits from all 27 pension funds stood at roughly 226,000, the number of future beneficiaries stood at approximately 216,000. The rates of increase are, as in the previous year, based on a moderate rise in defined contributions. In line with the amount of investments for the account and risk of employees and employers, the mathematical provisions for the account and risk of employees and employers came to €12.7 billion.

The majority of pension funds' new business is expected to continue to come primarily from the transfer of existing pension commitments. This trend is reinforced by the 2008 VAG amendment, which allows further flexibilisation of the cover rules for non-insurance-type pension plans. However, in the year under review, approval was not required for any recapitalisation plans connected with acute shortfalls.

The investments for the account and risk of employees and employers fell to €12.7 billion at the year-end because of losses in value. The investments for the account and risk of pension funds rose by 12.3% to approximately €719 million in 2008.

BaFin made forecasts for 27 pension funds as at 30 June 2008. Since the assumed scenarios were quickly overtaken by the global financial crisis, BaFin made further forecasts adjusted to circumstances as at 31 October 2008. All pension funds demonstrated that their continued profitable existence would be guaranteed even in the event of unfavourable developments on capital markets. Possible shortfalls in covering guaranteed minimum benefits or in the own-fund endowment could be countered at an early stage.

Investments for the account and risk of employees and employers rose markedly.

Forecasts showed a stable economic position.



# V Supervision of banks and financial services institutions

## 1 Basis for supervision

### 1.1 Implementation of the Payment Services Directive



Sabine Lautenschläger,  
Chief Executive Director of  
Banking Supervision

On 22 October 2008, the Federal Cabinet adopted the draft of a law implementing the supervisory rules contained in the EU's Payment Services Directive<sup>15</sup> in German law. The Payment Services Implementation Act (Zahlungsdienstleistungsgesetz) is to come into effect on 31 October 2009. With the underlying Payment Services Directive, the EU has created the legal basis for the Single Euro Payments Area – SEPA. This aims to make cross-border payments in the EU as straightforward and quick as they are within the individual member states. At the same time, this Directive will involve a new supervisory framework, which is designed to address the operational and financial risks facing these institutions. Where the Payment Services Directive contains civil law guidelines, these are being implemented in German law through a discrete law under the control of the Federal Ministry of Justice.<sup>16</sup>

The Payment Services Supervision Act is a core element.

The main component of the implementation act is the Payment Services Supervision Act (Zahlungsdienstleistungsaufsichtsgesetz – ZAG). It creates a new supervisory framework for payment institutions providing domestic or cross-border payment services – as credit card companies or operators of financial transfer services – in the same way as credit institutions but – unlike banks – were previously not subject to any harmonised supervisory regime in the European Union. A harmonised supervisory regime creates the same competitive conditions for the provision of payment services. This is of crucial importance for the integration of payment transactions and the completion of the European internal market. The ZAG is also a key component in ensuring transparency for all market participants involved in domestic and cross-border payments.

The giro business and credit card business in section 1 of the Banking Act (Kreditwesengesetz – KWG) will be deleted when the ZAG comes into effect. In future, these transactions will be solely governed by the ZAG.

<sup>15</sup> Directive 2007/64/EC dated 13.11.2007, OJ EU No. L 319 dated 05.12.2007, p. 1.

<sup>16</sup> Act on the Implementation of the Consumer Credit Directive, the civil law part of the Payment Services Directive and the restructuring of the provisions in respect of the right of revocation and return.

### Determination of payment services.

The ZAG stipulates a number of institutions that can carry out payment services. In addition to certain credit institutions, these include so-called payment institutions. Under the law, payment institutions will in future be subject to solvency supervision by BaFin. Companies which provide payment services commercially or at a level that requires a commercially structured business operation, are regarded as payment institutions in this respect. The ZAG contains a list of payment services. This list only comprises services by a third party, which support execution of a payment between two parties – the originator and the recipient. It does not depend on the legal form of the relationship between the originator and the recipient.

### Requirements of payment institutions.

Payment institutions will need a licence for their activities in future. Among other things, an initial capital prescribed by law, the amount of which is based on the payment services to be provided, is a prerequisite for this. Payment institutions must also have adequate regulatory capital for their ongoing operations. They are also subject to specific cover requirements in the event of insolvency. For example, they must ensure that monies owned by the user of the payment service are not mixed with other persons' monies at any time. Payment institutions may also satisfy the cover requirements with an insurance policy. Since the funds handed to the payment institution in order to execute a payment order are not covered by a deposit protection scheme, particular importance attaches to the cover requirements.

If payment institutions satisfy the requirements of the ZAG, they should receive a licence to provide payment services across the EU once it comes into force.

## 1.2 Implementation of the Acquisition Directive

### Acquisition Directive creates transparent process.

On 27 August 2008, the Federal Cabinet adopted the Act on the Implementation of the Acquisition Directive.<sup>17</sup> The amendments to the Banking Act (Kreditwesengesetz – KWG) envisaged therein entered into force in March 2009. The Acquisition Directive<sup>18</sup> is based on a feasibility study undertaken by the EU Commission on behalf of EU finance ministers. In this study, the Commission was charged with investigating possible obstacles to cross-border mergers and acquisitions in the banking sector. The Acquisition Directive aims to establish a transparent assessment process for the acquisition of or increase in a qualified participating interest in an institution and to effect procedural harmonisation in the individual Member States. The new rules shall give the supervisory assessment process more legal certainty, clarity and predictability. To achieve this aim, the Acquisition Directive prescribes a definitive list of reasons for prohibiting the acquisition.

<sup>17</sup> Bundestag printed paper 16/10536.

<sup>18</sup> Directive 2007/44/EC dated 05.09.2007, OJ EU No. L 247 dated 21.09.2007, p. 1.

- Current provisions governing participating interests are being revised.

In German law, section 2c KWG already provides a regulation based on EU law for the duty to report and control of holders of qualified participating interests. The form and content of the participating interests report are also specified in section 2 of the Reports Ordinance (Anzeigenverordnung – AnzV), which will be replaced by the Holder Control Regulation in future.

Implementation of the Acquisition Directive is leading to an amendment to section 2c KWG, whereby the procedure will be formalised on the one hand and the reasons for rejection extended on the other.

- Formalised procedure.

The newly revised section 2c KWG contains clear requirements in terms of both form and content for the procedure governing participating interests. It also stipulates the deadlines by which BaFin has to provide confirmation of receipt of the complete report, request additional documentation, if any, and carry out the assessment procedure. A maximum period is envisaged for the supervisory assessment of the participating interest report: in principle, the assessment procedure has to be completed within 60 working days of receipt of a complete report. This period can be extended by a maximum of 20 working days in the case of prospective acquirers in the EU, otherwise by a maximum of 30 working days if BaFin has to request additional information.

- List of grounds for prohibitions is expanded.

On implementation of the Acquisition Directive, further circumstances will be added to the definitive list of grounds for prohibition in section 2c KWG. In future, it will also be possible for a prohibition to be based on one of the following:

- the future manager is not reliable or not sufficiently qualified,
- the report is incomplete or inaccurate or does not meet the requirements of the Holder Control Regulation,
- a connection exists with money laundering or the financing of terrorism or
- the entity subject to notification requirements is not as financially sound as required.

In cases where the acquirer is domiciled in another EU Member State and is subject to supervision in that State, the competent authorities must work together in future. In this connection, they must exchange all relevant information that is required to be able to assess the suitability of prospective acquirers.

#### **Judgement on forbidding the acquisition of a participating interest.**

In its judgement of 21 February 2008, the Frankfurt Administrative Court rejected the appeal by prospective acquirers from the Eastern European economic area against the prohibition of the acquisition of a qualified participating interest in a bank. On the basis of section 2b (1a) KWG (previous version), BaFin prohibited the claimants' acquisition of shares in this institution. In so doing,

BaFin based its decision substantially on the prospective acquirers' unreliability in view of the lack of traceability regarding the funds provided for the acquisition.

According to the submission by the prospective acquirers, these funds were generated solely on the basis of verbal agreements.

The Frankfurt Administrative Court seconded BaFin's arguments with regard to the lack of traceability concerning the origin of the funds. In so doing, it drew attention to the fact that the assumed dispensability of legally binding agreements with regard to business activities taking place over several years and involving substantial financial sums does not comply with the customary practices of the European Economic Area. In view of the circumstances and the difficulties regarding the traceability of the business operations, no fault was to be found with the assessment that the prospective acquirers did not satisfy the demands to be made in the interests of the institution being soundly and cautiously managed either.

However, the judgement is not yet legally binding. The Hesse Administrative High Court has permitted the appeal submitted by the claimants on account of the particular factual and legal difficulties.

### 1.3 Holder Control Regulation

BaFin made the draft of the Holder Control Regulation available for public consultation at the end of 2008. Following conclusion of the consultation process in the meantime, the Holder Control Regulation entered into force in March 2009 together with the Act on the Implementation of the Acquisition Directive. The Holder Control Regulation drafted by BaFin is binding and stipulates which documents and explanatory notes from the report on the acquisition or increase of participating interest are to be submitted for qualified participating interests in accordance with section 2c KWG. With the regulation, BaFin is implementing a requirement of the Acquisition Directive and a joint recommendation from the 3Level3 committees (3L3) CEBS, CEIOPS and CESR, which interprets this Directive.

The binding nature of the regulation covering the notification and assessment process is intended to ensure that the entity subject to notification requirements is aware of its obligations even before submitting its notification of intent and can therefore contribute to the rapid start-up of the inspection process. At the same time, the Holder Control Regulation establishes a transparent assessment procedure. Thus the procedure for supervisory inspections not only becomes clearer and more predictable, it also ensures greater legal certainty.

Reason for and content of the Holder Control Regulation.

Aims of the Holder Control Regulation.

## 1.4 New leasing and factoring statutory definitions

When the annual tax code for 2009 entered into force, factoring and finance leasing were included in the KWG as new financial services on 25 December 2008. Companies, which regularly buy receivables on the basis of framework agreements (factoring) or offer finance leases, now need a licence from BaFin for these activities (section 32 KWG). The reason for this is the increased importance of these institutions to the economy and the financial system. If providers of factoring services and finance leases did not function smoothly because of problems in the management of their business for instance, this could damage large parts of the economy.

● Fictitious licences for companies which are already operating.

However, the law presumes particular fictitious licences for companies that are already operating in the market (section 64j KWG). Under section 64j (1) KWG, companies that already had a licence to conduct one or more banking or specific financial services on 25 December 2008 are deemed to be issued with a licence to offer factoring and finance leasing services from this date. In this case, a report to BaFin would not be required. For financial services institutions which do not yet have a licence under the KWG, the licence to offer factoring and finance leasing services is deemed to be issued from 25 December 2008, if they reported that they carry out these activities by 31 December 2009 (section 64j (2) KWG). The law contains an extended report period up to 31 December 2009 for smaller companies.

● Formal report procedure – limited supervision.

Unlike the licence procedure defined in section 32 KWG, the report process defined in section 64j (2) of the KWG is a purely formal procedure; the content of the report is not examined. The licence is deemed by law to have been granted retrospectively to 25 December 2008, if the report was received on time and in full by BaFin. From this moment, the companies fall under the KWG as financial services institutions. This means that they have to satisfy the requirements for an adequate risk management system and internal control procedure as well as certain reporting duties required by the KWG. The provisions on preventing money laundering and on the reliability of managers and shareholders also apply. BaFin may also order on-site investigations with the aim of establishing how far a company complies with the requirements of the KWG and the Money Laundering Act (Geldwäschegesetz). Otherwise, however, lease and factoring companies are excluded from ongoing supervision. They are, for example, not subject to the requirements on own-fund adequacy, the large-exposure regime and the liquidity provisions.

### Factoring and finance lease providers

Factoring involves the commercial purchase of receivables. The vendor, typically a small or medium-sized company, receives liquidity before the receivable falls due and this may save him from

having to borrow from banks. According to information provided by the German Factoring Association (Deutscher Factoring-Verband), its member companies' sales came to approximately €83.5 billion in 2007.

Finance leasing also represents an alternative form of financing to a bank loan. Here, the lessor assigns an economic asset to the lessee for its use. In return, the lessor receives a fee, which finances and amortises the asset over the term of the agreement. In economic terms, the lessor therefore grants the lessee a loan amounting to the acquisition cost of the asset. In this case, it is not ownership of an asset but its use that creates value. Leasing has become an increasingly important part of companies' investment. The Bundesverband Deutscher Leasing-Unternehmen (Federal Association of German Leasing Companies) assumes that lease investments now represent 24% of all capital investment. Economic assets totalling some €200 billion are covered by lease agreements. In the year under review, new business came to approximately €57 billion.

● Factoring and finance lease Guidance Notices.

In December 2008, BaFin published a Guideline Notice on the preconditions for fictitious licences in the report procedure as well as a separate report form. It also issued Guideline Notices on the statutory definitions of factoring and finance leases in January 2009. All Guideline Notices and forms are available on the BaFin website.<sup>19</sup>

## 1.5 Further changes to supervisory law

### Extension to the exemption contained in section 31 (3) KWG

● Contribution towards reduction in costs.

When implementing the Acquisition Directive, the legislator made an additional change to the KWG, unrelated to the Directive; it relates to the statutory definition of exemption contained in section 31 (3) KWG. This gives parent companies the option of exemption from specific consolidation duties regarding their subordinate companies through a simplified procedure. The change to the law suggested by BaFin extends the area of application of this simplified procedure. Companies can now also exempt themselves from the obligation to include a subordinate company in the summarised monthly returns. Previously a company had to undergo a separate administrative procedure for this. The waiver of this separate procedure also saves costs.

● BaFin has waived the separate procedure since as early as 2008.

BaFin waived the separate procedure, which is considered by the government as being outdated, as early as May 2008 – in the run-up to the above-mentioned change in the law.<sup>20</sup> This led to an immediate saving on bureaucratic costs at many institutions.

<sup>19</sup> [www.bafin.de](http://www.bafin.de) » English Version » Publications » Guidance Notices.

<sup>20</sup> Circular 6/2008 (BA).



#### Fourth Ordinance Amending the Country Risk Ordinance

The fourth Ordinance Amending the Country Risk Ordinance entered into force on 1 January 2009. With this Ordinance, BaFin synchronised the Country Risk Ordinance and the KWG or the Ordinance Governing Large Exposures and Loans (Großkredit- und Millionenkreditverordnung – GroMiKV). It should be stressed that the new provisions on reducing risk in sections 29 to 43 GroMiKV also apply when establishing the duty to report under the Country Risk Ordinance. The amendments are to be taken into account for the first time on the 31 March 2009 reporting date.

#### Amendment to the Building Societies Ordinance

In the year under review, initial discussions took place with the Associations regarding the planned amendment to the Buildings Societies Ordinance. The aim is to standardise the collective and non-collective maximum amounts for non-secured loans and for loans against a letter of intent and to raise this ceiling to €30,000. This should reduce the amount of bureaucracy entailed in granting smaller residential construction loans – most notably for maintenance and modernisation purposes – and simplify the process. This will allow building societies, which unlike other financial institutions are very restricted in their provision of unsecured loans, to expand the financing of smaller projects, retain customer groups in this segment and consequently increase their earnings capacity.

The procedure under which allocations to the fund required by building and loan association rules (“Fonds für bauspartechnische Absicherung”) are calculated is also to be revised. The fund, which is enshrined in law as an additional hedging instrument, is designed to guarantee the allocation of building society funds. The purpose of the planned amendment is to adequately depict new rates in the building society sector even when calculating the allocations.

#### Amendment to the Pfandbrief Act (Pfandbriefgesetz)

The first amendment to the Pfandbrief Act (PfandBG), which was launched in 2008, should contribute to making the already very secure Pfandbrief product even more secure. The amendments came into force at the end of March 2009. The law explicitly provides for Pfandbrief institutions having to maintain a liquidity buffer in cover funds for 180 days, to guarantee the Pfandbrief's liquidity at all times. BaFin had explicitly argued for this statutory minimum buffer.

### 1.6 Further development of MaRisk

The experiences gathered during the financial market crisis are also having an impact on the minimum requirements for risk management (MaRisk) which institutions have had to apply in full

● Directive is to be standardised and simplified.

● New procedure for calculating allocations.

● Financial market crisis brings about amendment to MaRisk.

since 1 January 2008. In particular, the guidelines for institutions' risk management contained in the recommendations of the Financial Stability Forum (Draghi Report) are to be implemented. The MaRisk expert panel, which includes experts from the various institutions, auditors, representatives of the various associations and supervisors, will be involved – as it has been successfully in the past – in the development of the MaRisk amendment. In February 2009, BaFin published the draft of the revised MaRisk for consultation. It is expected that the final revised version of MaRisk will be published in spring 2009.

● Greater focus on concentration risks.

Even greater importance is attached to the management of institutions in the revised MaRisk so as to sharpen their awareness of concentration risks. Because of their complexity and particular character, concentration risks constitute the risk of loss, which is most difficult to calculate. If concentration risks materialise, this often has major repercussions, as the current financial markets crisis has shown. Crucial drivers, such as concentration in specific addresses, sectors, regions or even products, can frequently only be distinguished from each other with difficulty. The situation is exacerbated by dependencies, such as between specific sectors, which make the management of such risks more difficult.

● Liquidity risks are particularly significant.

The distortions on financial markets have also illustrated the particular significance of liquidity risks. The Basel Committee has therefore developed a complete list of "Principles" based on the recommendations of the Financial Stability Forum, which will find their way into national law via EU guidelines (CRD Amendment Directive). Picking up on this, the MaRisk amendment also expands the relevant MaRisk module.

● Development of stress testing requirements.

Against the background of the financial market crisis, the MaRisk requirements for the stress testing of risks must also be tightened up. Stress tests not only help institutions to assess their susceptibility to unusual but plausible events, but are also an important means of compensating for deficits in quantitative risk models.

Further issues in the revision of MaRisk include incentive and payment systems, risks to reputation or credit ratings based on external ratings.

## 1.7 Circular on the Act Implementing the Markets in Financial Instruments Directive

In 2008, BaFin issued several circulars explaining the legal changes resulting from the Act Implementing the Markets in Financial Instruments Directive (Finanzmarkttrichtlinie-Umsetzungsgesetz – FRUG) in greater detail. On the one hand, this involves the procedure for reporting contractually bound brokers to the public register and, on the other hand, advice on regulatory-capital

compensating insurance in accordance with section 33 (1) sentence 2 and 3 KWG.<sup>21</sup>

BaFin specified in detail how banks and securities service providers have to control their employees' transactions in a further circular concerning section 33b of the Securities Trading Act (Wertpapierhandelsgesetz – WpHG) and section 25a KWG.<sup>22</sup> Here, BaFin explained the requirements made on banks and securities services providers by the obligation to monitor employee transactions which has been in force since November 2007. It makes clear whom the institutions must control, for example, which transactions are to be viewed as employee transactions and the organisational preconditions they can create to monitor these transactions in an appropriate manner. BaFin also lists appropriate organisational measures which a company can employ to comply with its obligations under section 33b WpHG: banks may create Chinese walls, for instance, or establish watch lists and restricted lists in order to prevent improper employee transactions.

BaFin also provides those market participants which are subject to the reporting requirements in section 9 WpHG with a guide to the statutory changes to reporting in two circulars.<sup>23</sup> The first circular governs the duty to report on the part of branches of European companies subject to reporting regulations and, among other things, makes clear – against the background of European law – when branches of foreign companies have a duty to report. In the second circular, BaFin provides information on how market participants subject to reporting requirements must identify individual types of transactions.

## 2 Ongoing solvency supervision

### 2.1 Authorised banks

The trend of recent years has continued among authorised banks in the year under review: their number fell further in 2008. Having supervised 2,074 authorised institutions in the previous year, BaFin supervised 2,048 credit institutions and securities trading banks at the end of the year under review. BaFin distinguishes between four groups of institutions among the banks under its supervision: lending banks, institutions belonging to the savings bank sector, institutions belonging to the cooperative bank sector and other institutions. The lending banks include, for instance, the major banks, private banks and branches of banks from outside the European Economic Area. In addition to the Landesbanks, the

<sup>21</sup> www.bafin.de » English Version » Publications » Circulars 2/2008 (WA) and 3/2008 (WA); also see 2007 Annual Report, p. 110 f.

<sup>22</sup> www.bafin.de » English Version » Publications » Circular 8/2008 (WA).

<sup>23</sup> www.bafin.de » English Version » Publications » Circulars 5/2008 (WA) and 11/2008 (WA).

savings banks sector also includes the public savings banks and free savings banks. Allocation to the savings bank or cooperative banks sector depends primarily on the economic ties between the institutions. This is why DZ Bank and WGZ Bank are assigned to the cooperative sector. The group of other institutions comprises the building societies, mortgage banks, securities trading banks and both the federal and state housing promotion banks (Förderbank).

Table 13

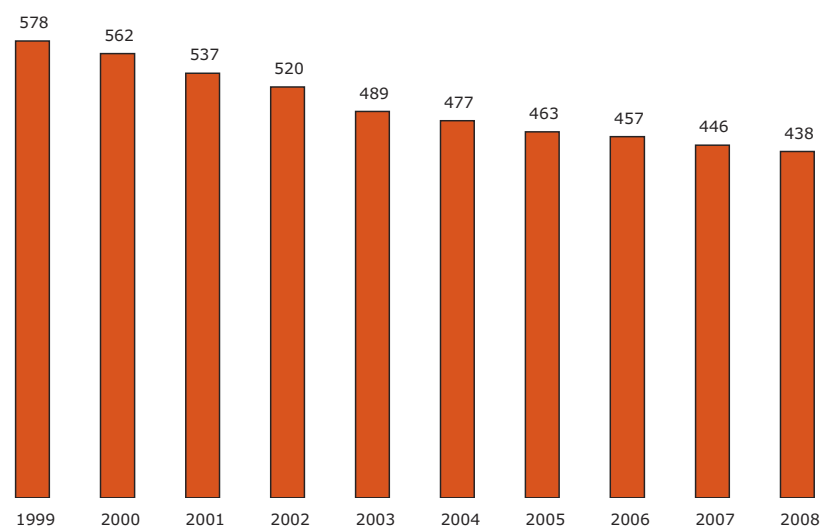
**Number of banks by type of institution**

Institution type	2008	2007
Lending institutions	183	204
Institutions in the savings bank sector	448	458
Institutions in the cooperative sector	1,247	1,281
Other institutions	170	131
<b>Total</b>	<b>2048</b>	<b>2,074</b>

Number of savings banks falls to 438 institutions.

Consolidation in the savings bank sector progressed rather slowly in 2008 – as was the case in previous years. While there were 446 savings banks in the previous year, the number fell to 438 institutions in the year under review. This equates to a reduction of just under 1.8%.

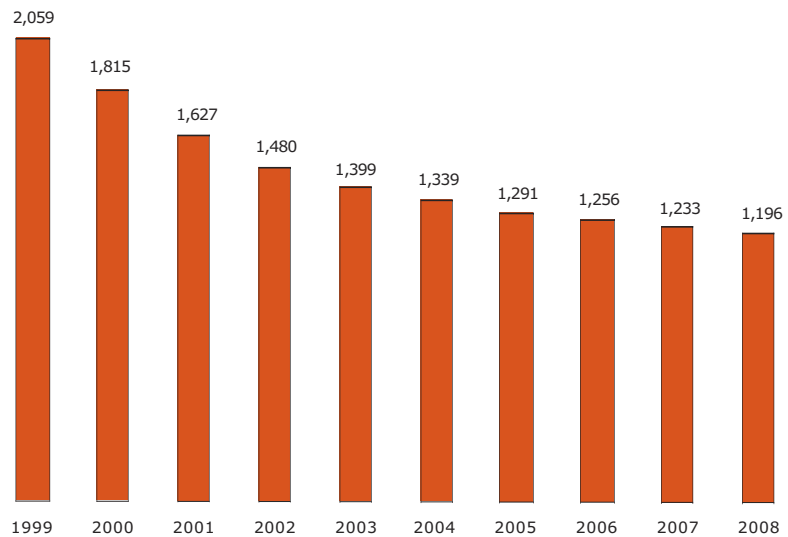
Figure 13

**Number of savings banks**

Merger process in the cooperative sector is accelerating.

At the end of the year under review, a total of 1,196 primary institutions, two central banks, ten institutions that are similar to central banks and 46 building cooperatives with savings schemes (which also form part of the cooperative banking sector) were covered by BaFin's supervisory work in the cooperative banking sector. As a result, the number of primary institutions declined by 37, or 3.0%. The pace of mergers in the cooperative banking sector has increased once more compared with the previous year.

Figure 14

**Number of primary cooperative banks**

● Group of Pfandbrief issuers expands.

The absolute number of banks issuing Pfandbriefe remained virtually constant in 2008: it now stands at 62 institutions (previous year: 60). Nevertheless, the Pfandbrief bank sector was also subject to flux in the year under review. On the one hand, the number of institutions fell as a result of five mergers in total, most recently, for instance, as a result of the merger of Hypo Real Estate Bank International AG with Hypo Real Estate Bank AG. On the other hand, several new licences to conduct Pfandbrief business were also issued in 2008, such as to institutions from the savings banks sector. This means that the trend towards other credit institutions increasingly having a licence to issue Pfandbriefe, in addition to the traditional issuers – former mortgage banks or Landesbanks – is continuing.

● Commerzbank acquires Dresdner Bank.



At the end of August 2008, there was a major step forward in the consolidation of the German private banking sector. Allianz SE and Commerzbank AG agreed on the sale of Dresdner Bank AG and consequently sealed the largest takeover to date within the German banking sector. The original agreement concluded in August was revised in November 2008 against the background of the crisis on financial markets in order to accelerate the takeover. The parties agreed that Allianz would sell its participating interest in Dresdner Bank to Commerzbank in its entirety at an earlier date. The sale was closed in mid-January 2009. As a result, Allianz became a major shareholder in the new Commerzbank and at the same time its exclusive insurance partner via a long-term cooperation agreement. Commerzbank hopes to be able to achieve considerable synergies through the integration of Dresdner Bank.

Table 14

**Foreign banks in the Federal Republic of Germany**

(As at 31 December 2008; previous year's figures in brackets)

Country	Subsidiaries of banks	Subsidiaries of non-banks	Branches	EU subsidiaries	Representative offices
Egypt	1 (1)				
Andorra					1 (1)
Azerbaijan			(1)		1 (1)
Australia		1 (0)	1 (1)	1 (0)	
Belgium	3 (3)			2 (1)	1 (1)
Brazil			1 (1)		2 (1)
China, PR			4 (3)		1 (2)
Denmark				3 (3)	2 (2)
Estonia					1 (0)
Finland				1 (1)	
France	5 (4)	1 (1)		21 (20)	11 (12)
Greece	1 (1)			2 (1)	
United Kingdom	4 (5)	2 (1)		9 (9)	2 (2)
India			1 (1)	1 (1)	
Iran	1 (1)		3 (3)		
Ireland				3 (2)	2 (1)
Iceland				1 (2)	
Israel					2 (3)
Italy	2 (3)			5 (11)	2 (1)
Japan	2 (2)	1 (1)	3 (3)		3 (4)
Canada		1 (1)			
Latvia				1 (1)	
Liechtenstein	1 (1)				
Luxembourg	2 (2)			1 (1)	
Mongolia					1 (0)
Netherlands	6 (6)	2 (1)		19 (18)	
Norway				1 (1)	
Austria	1 (1)			11 (11)	6 (7)
Pakistan			1 (1)		
Philippines					3 (3)
Portugal					6 (6)
Russia	1 (1)				4 (4)
Sweden	1 (1)	1 (0)		3 (2)	
Switzerland	8 (5)	1 (1)		3 (4)	3 (2)
Slovenia	1 (1)				
Spain	2 (1)			2 (2)	5 (8)
South Korea/Rep. Korea	2 (2)				3 (3)
Tajikistan					1 (1)
Czech Republic					1 (1)
Turkey	4 (5)				5 (5)
U.S.A.	7 (8)	9 (10)	5 (5)	9 (8)	
Belarus					1(1)
<b>Total</b>	<b>55 (54)</b>	<b>19 (16)</b>	<b>19 (19)</b>	<b>99 (99)</b>	<b>70 (72)</b>

## 2.2 Economic development

● Financial market crisis spreads once more in 2008.

The financial market crisis, which emerged from the US sub-prime crisis, developed into a full-blown economic crisis during the year under review.<sup>24</sup> The failure in September of the US investment bank Lehmann Brothers, which was assumed to be too big not to be rescued, was a particularly far-reaching development in this regard. As was the case for all those involved, BaFin was also surprised by Lehmann Brothers' insolvency and the extent of the crisis that followed. Because of the ensuing crisis of confidence, even solvent banks ran into problems in terms of liquidity. As a consequence of the loss of confidence, banks preferred to hoard surplus liquidity than lend it on the interbank market. For many institutions, this caused some substantial funding problems which were in the end only absorbed through targeted rescue measures by the government.

● Federal government creates the Special Fund Financial Market Stabilisation.

Ultimately, the federal government passed the so-called Financial Market Stabilisation Act, worth €480 billion in total, in mid-October 2008. The Special Fund Financial Market Stabilisation (SoFFin), which was created as a result, has the task of issuing guarantees for financial companies' debt securities and liabilities, endowing under-capitalised financial institutions with additional regulatory capital and assuming risk positions. After a cautious start, several institutions – both public and private – have subsequently applied to SoFFin for a guarantee or help with recapitalisation.

● Refinancing of traditional Pfandbrief banks particularly affected.

### Position of Pfandbrief banks

Although the trend towards other credit institutions conducting Pfandbrief business – in addition to traditional Pfandbrief providers – is intensifying in this particular market, traditional issuers continue to account for by far the largest share in volume terms. In this respect, the crisis of confidence on financial markets was also the focal point for those institutions where Pfandbrief business represents the central area of business. This is because the crisis, by its very nature, affects in particular those institutions which are very heavily dependent on the smooth running of the money and capital markets. This refers primarily traditional Pfandbrief issuers on a "stand alone" basis which were unable to fall back on alternative sources of refinancing in the wake of continuing market distortions.

● Difficulties for two traditional Pfandbrief banks.

Two of these Pfandbrief issuers, which rely largely on wholesale funding, i.e. interbank trading alone, namely Düsseldorf Hypothekenbank AG and the Hypo Real Estate Group, fell into considerable difficulties in 2008. While Düsseldorf Hypothekenbank AG was taken over by the private sector in April 2008, before the interbank market dried up from mid-September, and consequently was saved before the collapse, the much larger HRE Group with its three German mortgage banks and the Irish public sector and infrastructure financing specialist DEPFA Bank plc

<sup>24</sup> See Chapter II.1 for a chronology of events.

could only be stabilised with the help of the private sector and considerable government support.

### **Hypo Real Estate Group (HRE Group)**

Once the financial market crisis peaked following the collapse of the US investment bank Lehmann Brothers in mid-September 2008 to the extent that interbank trading practically ground to a halt, the HRE Group – primarily its Irish subsidiary DEPFA Bank plc – was no longer able to cover even its short-term refinancing requirements. The subsidiaries of the HRE Group, which specialise in high-volume property, government and infrastructure finance, do not operate any deposit business and are therefore heavily dependent on the functioning of the money and capital market. This dependency was further increased by the takeover of the Irish DEPFA Bank plc in October 2007.

The HRE Group was initially promised a credit facility of €35 billion as part of a joint rescue plan. Besides a consortium of German financiers, the federal government, the Bundesbank and BaFin were also involved in the rescue plan. The ongoing difficulties in the market climate and the downgrading of the ratings for HRE subsidiary banks in the end led to a far greater demand for liquidity than had originally been forecast. As a result, the credit facility was increased to €50 billion; the HRE Group also entered into negotiations with the Special Fund Financial Market Stabilisation Fund (SoFFin) on the provision of liquidity guarantees and regulatory capital. As a stop-gap, SoFFin provided limited liquidity guarantees amounting to €52 billion.

The Bank Nationalisation Act, which entered into force on 9 April 2009 in the form of the Financial Market Stabilisation Act (Finanzmarktstabilisierungsergänzungsgesetz – FMStErgG) and was largely tailored to the HRE, allows the federal government a limited period of time to nationalise credit institutions whose importance is systemic in nature – if necessary by expropriating their shareholders. However, SoFFin initially submitted a takeover offer to the HRE shareholders in mid-April 2009, which was previously permitted by BaFin.

● Imbalanced business model particularly vulnerable to crises.

These two most recent cases confirm the observations gathered over many years that it is especially those institutions which get into difficulties which tend to have a business model that is imbalanced in its focus – in this case predominantly on public sector finance. In the past, this was determined by the fact that adequate earnings were often only achievable by refinancing on an unmatched basis, in other words: funds were lent long-term and refinanced short-term. In so doing, however, the institutions are forced to depend on functioning money and capital markets to cover their refinancing requirements at all times.



Not least because of this development, BaFin assumes that in future its focus will be concentrated far more on business models' ability to withstand crises. The issuer landscape is also likely to consolidate further over the next few years with the trend towards mergers within groups of companies – which also have other sources of refinancing – expected to continue.

- Sharp slump in the Pfandbrief market from September 2008 onwards.

In the year under review, it looked for a long time as though the Pfandbrief product might escape the intensifying crisis; initially, issue volumes even rose sharply compared with the previous year. This gratifying trend was brought to an abrupt halt from September 2008 by the collapse of the US investment bank Lehman Brothers and the rescue plan for the HRE Group, which became necessary a few weeks later; marked falls were now recorded on the Pfandbrief market as well.

- Competition for the Pfandbrief in the form of government-backed bonds.

In addition, a new source of competition in the short-term segment made life difficult for the Pfandbrief: domestic and foreign bonds backed with government guarantees. Although the Pfandbrief remains one of the safest forms of investment, it can only appear more attractive in direct competition with government-backed paper in terms of yield. But it is precisely this, which once again ultimately depresses the issuer's earnings. The extension in term of this government guarantee from three to a maximum of five years by the FMStErgG could further increase the pressure on the Pfandbrief market.

- Hope for the Pfandbrief market.

However, the Pfandbrief market is far from "dead". At the beginning of the new year, there were signs of issue volumes trending upwards. Two high volume Jumbo Pfandbrief issues of over €1 billion each were even placed – admittedly at far higher spreads. It was precisely during the financial crisis that, out of all the refinancing instruments, the Pfandbrief was able to hold its own longest. In view of its ability to withstand crises, there is a justified hope that the Pfandbrief market will rapidly regain momentum as soon as investors' confidence is restored. The first amendment to the PfandBG, which was initiated in 2008 and which has made the Pfandbrief even more secure since it entered into force in March 2009, should also contribute to this.

### **Position of the private, regional and specialist banks**

The crisis on the financial markets has also affected the private, regional and specialist banks. Some institutions have been affected directly because they had Icelandic bonds or sub-prime paper in their portfolios, for example. However, the majority of institutions were only indirectly affected by the financial market crisis, such as through higher refinancing costs, a shortage of liquidity or an increase in risk provisioning. As a result, some institutions applied to SoFFin or considered making applications of this kind in order to make use of guarantees to reduce their refinancing costs.

### Insolvency of Lehman Brothers Bankhaus AG

The insolvency of major parts of the US Lehman Group brought about by the financial crisis also had serious consequences in Germany. Lehman Brothers Bankhaus AG, the Group's only banking unit outside the USA, with total assets of some €16.1 billion, was hit here. Lehman Brothers Bankhaus AG had commenced operations in 1988 and concentrated on lending business, treasury, investment banking and trading in interest rate and currency derivatives for its customers. In addition, the Bank also accepted deposits from institutional investors. It operated internationally via branches in South Korea, the United Kingdom and Italy as well as providing cross-border services. Virtually all types of business were carried out within the group. On the basis of this fact and the emerging crisis facing the group, BaFin imposed additional duties of disclosure on particularly risk-relevant areas of business as early as the beginning of 2008. When substantial doubts concerning the Group's ability to survive arose, BaFin also appointed staff to supervise the institution.


In September 2008, it became clear that the Lehman Group could not survive without external assistance. Intense consideration was given to support measures – both in the form of a private takeover and in the form of a government rescue. However, early in the morning of 15 September 2008, the US supervisory authorities announced that they were not prepared to offer any support. Central units within the Lehman Group subsequently applied for creditor protection, first in the United Kingdom and then in the USA. As a result, the German Lehman Brothers Bankhaus AG was threatened with insolvency. To protect the remaining assets of Lehman Brothers Bankhaus AG, BaFin was forced to impose an immediate moratorium on any sale or payments.

The bank and its owners had the opportunity to take remedial action under the protection of the moratorium. However, these efforts were ultimately unsuccessful – and were not helped by the further intensification in the market. Following expiry of the statutory six week deadline set when the moratorium was imposed, BaFin subsequently had to determine compensation (section 5 (1) sentence 2 of the Deposit Guarantee and Investor Compensation Act (Einlagensicherungs- und Anlegerentschädigungsgesetz – EAEG). After the over-indebtedness of Lehman Brothers Bankhaus AG was also stated in a report, BaFin applied to have insolvency proceedings initiated on 12 November 2008. On the following day, the Frankfurt Local Court opened insolvency proceedings against the bank's assets and appointed a liquidator. Since that date, Lehman Brothers Bankhaus AG has been in liquidation.

● Weserbank AG first compensation case in 2008.

However, the first bankruptcy of a bank during the year under review concerned the far smaller Weserbank AG (previously Viehmarktsbank der Unterweserstädte GmbH) based in Bremerhaven, which BaFin closed on 8 April 2008 on account of over-indebtedness reported by the Management Board. Weserbank

was no longer able to generate the income required to cover its running costs in the long term. Attempts by the owners to contribute the capital needed for the bank's survival at short notice remained unsuccessful until the end. At the instigation of BaFin, the Bremerhaven Local Court thereupon initiated insolvency proceedings against the assets of Weserbank. Compensation was determined by BaFin as early as 16 April 2008; this is the legal precondition for compensating depositors. Since Weserbank was a member of the (voluntary) Deposit Fund of the Association of German Banks (Einlagensicherungsfonds des Bundesverbandes deutscher Banken e.V.) in addition to the (statutory) Compensation Scheme of German Banks (Entschädigungseinrichtung deutscher Banken GmbH), deposits of some €1.8 million per investor were protected in this case. Investors were compensated virtually in full just a few months later.

 Crisis and sale of IKB Deutsche Industriebank AG.


Another issue that defined the year under review was the ongoing crisis at IKB Deutsche Industriebank AG, which was eventually concluded by means of its sale to a US financial investor.

#### **Position of IKB Deutsche Industriebank AG**

IKB found itself in a crisis that threatened its existence at the end of July 2007, as a consequence of the sub-prime crisis. The bank's looming insolvency was only averted by various rescue measures involving funds from its shareholder – the German reconstruction loan corporation (Kreditanstalt für Wiederaufbau – KfW) – and the federal government. At the end of October 2008, the KfW sold its investment of some 90.8% in the share capital of IKB to the US financial investor Lone Star, thereby completing the purchase agreement concluded in August 2008. This makes Lone Star the largest shareholder in IKB.

At the end of October 2008, the EU Commission approved the government aid provided since July 2007, subject to certain conditions. Among other things, the conditions envisage a marked reduction in IKB's business activities, its complete abandoning of property finance and the closure of some foreign offices. Its total assets are to be reduced to €33.5 billion by September 2011.

Given the general situation on the money and capital markets since September 2008, IKB had applied to SoFFin for a guarantee of the debt to be issued. At the end of December 2008, SoFFin subsequently approved a guarantee facility of up to €5 billion. IKB now plans to secure its liquidity with the government-backed debt scheduled for issue in 2009.

 Crisis is a double whammy for Autobanks.

The general liquidity crisis has also led to a squeeze on refinancing for Autobanks (banks owned by car manufacturers, which offer banking services including car financing). Matters were exacerbated by the problems facing the automotive sector as a whole. Where Autobanks have licences to conduct deposit business, there were signs of a trend towards using high interest

deposits to fund lending operations. However, the institutions also ran into difficulties at the end of the year in securing refinancing via ABS transactions on the capital market. They were therefore forced to increasingly hold ABS paper in their own portfolios to produce securities that were eligible in ECB terms as collateral.

#### **Kaupthing Bank hf., Germany branch**


The Icelandic Kaupthing Bank hf. offered instant access savings accounts through a so-called EEA branch in Germany. A peculiarity of these EEA branches is that they are not subject to BaFin's solvency supervision but to that of their country of origin. The same is true of their membership of a statutory deposit protection scheme.

At the beginning of October, events began to spin out of control in Iceland: during the night of the 7 October 2008, the Icelandic government warned of a looming national bankruptcy as a consequence of the Icelandic banking crisis. The following morning, BaFin therefore asked the German branch of Kaupthing Bank to report on its liquidity. In the course of the same day, fears that the branch's customers would withdraw their deposits on a large scale were confirmed. BaFin contacted Kaupthing's head office and the Icelandic Financial Supervisory Authority, the FME, to ensure that the branch had sufficient liquidity.

Subsequently, the Icelandic bank's head office initially allowed the branch liquidity several times a day when requested. However, the significant withdrawal of deposits continued the following day. On the morning of 9 October 2008, the branch announced that the head office in Iceland had blocked German depositors from accessing their accounts with the branch electronically. BaFin therefore issued the branch with a moratorium on any sale or payments at midday with the aim of safeguarding the branch's remaining assets. There was also a serious risk that the branch would no longer be able to fulfil its commitments to its creditors.

#### **Position of the building societies (Bausparkassen)**

The 25 German building societies have been comparatively unaffected by the financial crisis. Loan defaults remained low thanks to their specialisation in providing construction financing for private housing. Write-downs on investments were only required to a very minor degree. The provisions of the Building Societies Act (Bausparkassengesetz) restrict building societies' to investing in particularly secure paper. For instance, they may not acquire any ABS paper or other structured securities. In essence, their activities are refinanced from building society deposits, meaning that the institutions have not had any problems procuring funds. Only the building societies, which had recourse to the capital market to refinance their non-collective transactions, felt the increase in refinancing costs.

 Building societies remained largely unscathed by the crisis.

● Home financing subsidy and “Housing Riester”.

The trend in building societies’ new business was rather subdued in the year under review despite some special factors. Since the beginning of 2009, the government’s home financing subsidy may only be used for housing purposes. The only exceptions apply to building society savers, who are less than 25 years old when they start saving. Previously, the government subsidy could be used for any purpose after a seven year waiting period. Building societies therefore encouraged people to set up buildings savings plans under the old conditions before the end of the year. In the year under review, the rules were amended to include private residential property in the state subsidised private old-age pension provision scheme (“Housing Riester”). Since 1 November 2008, building societies have therefore offered buildings savings plans as a means of old-age pension provision. Initial experiences with this new product indicate that it may well generate new business for building societies.

### Position of the Landesbanks

The downward trend that was generally apparent in the banking landscape continued unabated for the remaining seven independent Landesbanks in 2008.

● Landesbanks suffer severe losses.

One Landesbank, namely SachsenLB, fell victim to the escalating sub-prime crisis as early as 2007. Towards the end of 2007, significant difficulties also became apparent at WestLB AG. At the end of March 2008, the owners of WestLB AG therefore set up a risk shield, which is linked to a guarantee by the State of North Rhine-Westphalia to assume losses of €5 billion. At the end of September 2008, BayernLB announced that it had to write down its securities portfolio by several billion euros, requiring its capital owners to take capital measures worth billions. Other Landesbanks too, such as HSH Nordbank and subsequently LBBW, had to announce significant (valuation) losses. WestLB, BayernLB and HSH Nordbank have now applied to SoFFin for guarantees which would allow them to issue government-backed securities.

### WestLB risk shield

In response to the losses accrued to date from the financial market crisis, the owners of WestLB AG – the state of North Rhine-Westphalia, the Rhine and the Westphalia-Lippe Savings Bank Association as well as the Rhineland and Westphalia-Lippe Regional Associations – announced that they would establish a risk shield on 8 February 2008. The aim was to free the institution from the risks of its investments – running into billions – in structured securities on the US real estate market.

On 31 March 2008, a WestLB securities portfolio worth around €23 billion was transferred to a special purpose vehicle as part of a securitisation transaction. The portfolio contained securities denominated in US dollars, pounds sterling and euro (commercial paper, medium-term notes, capital notes and income notes), which

were previously held in various special purpose vehicles floated by WestLB and structured investment vehicles, among others.

To refinance this, the special purpose vehicle initially issued unrated, unlisted debt instruments, which are divided into various tranches. In December 2008, the senior tranche was rated by a recognised rating agency. The junior tranche is hedged by a first loss piece amounting to €5 billion, which is guaranteed by the State of North Rhine-Westphalia. The EU Commission treated the guarantee as rescue aid for a period of six months following the announcement of this step. However, for the guarantee to be subsequently reclassified as restructuring aid, as planned, the institution had to submit an acceptable restructuring plan. The EU attached certain conditions to the restructuring plan, which have to be fulfilled by 31 March 2009. A final decision by the Commission is pending. The EU Commission has classified utilisation of various guarantees from the respective federal states as aid. It has only approved this aid to date subject to stringent conditions.

### Position of the securities trading banks, stock brokers and electricity traders

Institutions benefit from the sellers' market.

Despite the negative trend on stock markets, securities trading banks and stock brokers were still able to benefit to some extent from the sellers' market in the year under review. Thanks to an increase in orders in the fourth quarter of 2008, some institutions were able to offset the summer months during which turnover volumes were low. On the other hand, the corporate finance (capital raising) environment deteriorated further compared with the previous year. There were no larger transactions, particularly IPOs.

Market situation demands business adjustment, cost management and consolidation.

The business development of securities trading banks and stock brokers was heavily dependent on their respective business focus. Only those institutions which had adapted their business to constantly evolving market conditions in previous years, were able to return a positive performance. Heavy pressure was therefore exerted above all on institutions, which have specialised in an imbalanced way in specific second liners. Cost management was required in view of slumping earnings. The weak market position also increased the economic pressure on institutions to merge and form larger units. This is especially true for the area of lead brokerage, the future of which is determined by the changing structure of trading floors and the increasing demands on market participants. Competition is leading to institutions also adjusting their range of services in line with their customers' requirements and developing into universal banks specialising in securities business. Examples of this are the inclusion of immediate access savings accounts in the range of services provided by some fund banks. Some banks are successfully operating their own multilateral trading systems. Trade in CFDs (contracts for difference), which some institutions launched to compete with

established British providers, also proved increasingly significant as a product for marketing to end customers.

- High energy prices encourage electricity trading.

The sharp rise in energy prices in 2008 has helped to increase interest in electricity futures trading further. Trading volumes on the EEX (European Energy Exchange) increased once more even though the market continues to be dominated by OTC trading involving physical settlement. Interest in energy related financial services remains comparatively weak by and large. Given the loss of confidence caused by the financial crisis, however, there is increasing interest in subjecting OTC transactions to exchange clearing (EFP). There is also the expectation on the part of licensed traders that customers will exploit the latest price changes to use financial products in protecting themselves against rising fuel costs.

### 2.3 Risk classification

- Risk profile as the basis for risk classification.

Within the scope of banking supervision, BaFin collaborates with the appropriate Regional Office of the Bundesbank to determine the risk classification. To this effect, the risk classification is derived from the risk profile. The Bundesbank assesses all major areas of a credit institution as part of its ongoing monitoring and combines the results in a risk profile. An institution's risk profile encompasses its risk situation and regulatory capital adequacy, its risk management as well as the quality of its organisation and management. It is based on the results of the annual audit and contains all other relevant information relating to the institution. It also takes account of the results of a model-based rating system, which is itself based on the banking supervisory reporting system.

- Risk classification influences supervisory action.

BaFin finalises this risk profile at least once a year. In so doing it decides on both the assessment of the institution in terms of banking supervision and on its risk classification. The result of the classification takes account of both the respective risk situation of the supervised institution and its significance for the German financial market, and depicts this assessment in a twelve field matrix. The Bundesbank and BaFin use the classification to determine the intensity of their supervision.

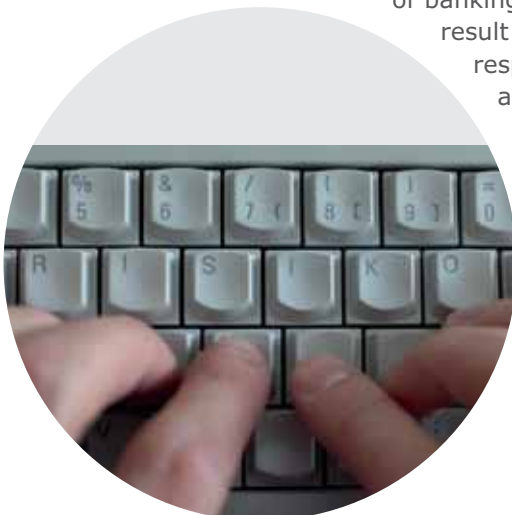


Table 15

**Results of the 2008 risk classification**

Institutions in %		Quality of the institution*				Total
		A	B	C	D	
Systemic relevance	High	0.1 %	1.0 %	0.4 %	0.2 %	1.8 %
	Medium	3.0 %	3.3 %	1.4 %	0.5 %	8.2 %
	Low	40.4 %	34.9 %	11.2 %	3.5 %	90.1 %
Total		43.5 %	39.2 %	13.0 %	4.2 %	100.0 %**

\* Including financial services institutions which are permitted to obtain possession or ownership of money or securities for their customers, or which carry out business or trading for their own account.

\*\* Differences in the overall total are due to rounding differences.

## 2.4 Supervisory actions

● Three types of special audit.

In its special supervisory audits, BaFin distinguishes between those requested by banks, those initiated by BaFin and scheduled audits. In the first case, BaFin only carries out an audit at the request of an institution, in the second case the initiative emanates solely from BaFin's requirements to establish the facts correctly. The third case includes audits where BaFin is involved on the basis of a schedule prescribed by law. This is particularly the case for audits of mortgage bank's cover assets, for which the PfandBG regularly stipulates a two-year interval.

● Special audits requested by banks and special audits initiated by BaFin.

Requested audits include, in particular, inspections of their internal risk measurement procedures such as those based on the IRBA (Internal Ratings Based Approach), the AMA (Advanced Measurement Approach) or internal market risk models. In the year under review, the first audits of internal procedures to measure liquidity risks were also carried out. Audits initiated by BaFin either take place for a concrete reason – such as to look into comments in the auditors' report – or routinely as part of its random monitoring programme. These audits allow BaFin its own in-depth view of an institution's risk situation.

● Total of 244 special audits in 2008.

In the year under review, BaFin carried out 244 special audits in total (previous year: 280). Of this figure, 163 audits were initiated by BaFin, 61 were requested by banks and 20 were required by law. In the case of audits initiated by BaFin, it should be noted



that the number of credit assessment audits (special lending-related audits) again fell sharply to only 23 compared with 35 in the previous year. This trend is also expected to continue in the current year. On the one hand, in 2008 there were fewer concrete reasons for checking credit exposure because the economic situation was (still) buoyant; on the other hand, this is also result of the qualitative supervisory approach, which BaFin has increasingly adopted with the implementation of Basel II. With 125 audits compared with 112 audits in the previous year, special audits initiated by BaFin focused most notably on the implementation of institutions' particular duties regarding the organisation and management of risk (section 25a KWG), which were specified by BaFin in MaRisk. Finally, 20 statutory inspections of cover assets were ordered in the year under review. Of these, BaFin awarded nine audits to external auditors and had its own staff carry out eleven audits.

Table 16

**Number of special audits**

	2008	2007
KSP	23	35
Section 25a (1) KWG	125	112
Organisation	5	4
Coverage	20	30
Other	10	17
Risk models	5	4
IRBA	45	70
AMA	8	8
Liquidity risk models	3	-
<b>Total</b>	<b>244</b>	<b>280</b>

The following table shows the distribution of the audits by groups of institutions. It is striking that only 7.3% of the institutions in the cooperative sector were audited. The far higher rate among lending banks, Other Institutions and institutions in the savings bank (Sparkassen) sector reflects the higher level of systemic relevance of these institutions for the purposes of the risk matrix on the one hand. On the other hand, the special burden posed by the requested IRBA and AMA audits as well as the statutory audits of cover assets are also reflected here. Scarcely either type of audit occurred in the cooperative sector in 2008.

Table 17

**Distribution by group of institutions of special audits in 2008**

	Lending institutions	Savings bank sector	Cooperative bank sector	Other institutions
KSP	1	8	14	0
Section 25a (1) KWG	19	31	62	13
Organisation	0	2	1	2
Coverage	4	8	0	8
Other	1	0	6	3
Risk models	2	2	1	0
IRBA	23	9	5	8
AMA	6	1	0	1
Liquidity risk models	2	0	1	0
<b>Total</b>	<b>58</b>	<b>61</b>	<b>90</b>	<b>35</b>
<b>in %</b>	<b>32.2 %</b>	<b>14.1 %</b>	<b>7.3 %</b>	<b>21.2 %</b>


The groups of institutions listed in table 17 also include their respective central banks; as a result, the Landesbanks are included in the savings bank sector and DZ Bank and WGZ Bank in the cooperative sector. The group called Other Institutions includes the former mortgage banks (Hypothekenbanken), for instance, building societies (Bausparkassen), banks with special functions (Institute mit Sonderaufgaben) and guarantee banks (Bürgschaftsbanken). It also includes some other special banks and financial services institutions that are permitted to obtain possession or ownership of money or securities for their customers or that carry out business or trading for their own account. If the audit figures are combined with the classifying risk matrix, it is clear how risk-oriented the special audits were. The table below only contains the audits carried out on the initiative of BaFin. Only in these audits is there a reference to the risk classification of the supervised institutions.

Table 18

### Distribution by risk class of supervisor-initiated special audits in 2008

Supervisor-initiated special audits		Quality of the institution*				Total	Institutions in %
		A	B	C	D		
Systemic relevance	High	1	8	5	1	15	42 %
	Medium	4	7	7	3	21	13 %
	Low	37	43	33	15	128	7 %
Total		42	58	45	19	164	8 %
Institutions in %		4.8 %	7.3 %	17.0 %	22.1 %	8.1 %	

\* Including financial services institutions that are permitted to obtain possession or ownership of money or securities for their customers, or that carry out business or trading for their own account

 Audits focus on problematic institutions, ...

As a rule, the more critically BaFin rates the quality of an institution, the greater is its requirement for an in-depth view of the bank's actual position. Accordingly, the ratio of supervisor-initiated audits rises to 22.1% for the problematic D-rated institutions. In recent years, the maximum number of audits were often carried out at C-rated institutions, which were "only" giving ground for concern, since the need for information may be greater there than at the banks, which have already been recognised as problematic. In 2008, various institutions slid from an unproblematic risk class to being rated C or even D within a few months because of the financial markets crisis, meaning that the proportion of D-rated institutions is relatively preponderant at the year-end.

... but good institutions are also examined.

Precisely because of the experiences of the last two years, BaFin continues to take the view that no areas should remain unaudited. This means that even institutions classified as good must be scrutinised by BaFin and its agents albeit at less frequent intervals.

Risk model audits at credit institutions.

At the end of 2008, a total of 15 credit institutions had received confirmation from BaFin to the effect that their internal market risk models met supervisory requirements. In five cases, institutions selected "full" use of internal market risk models.

### Backtesting

Institutions have to check the accuracy of their market risk models' forecasts with the help of a daily backtesting process. In so doing, they compare the hypothetical daily loss on a portfolio that is kept constant caused by actual movements in prices with the maximum loss forecast by the risk model, the so-called Value at Risk (VaR). In this context, the VaR is to be estimated with a 99% confidence level. If the hypothetical daily losses exceed the VaR more than five times in a period of 250 working days, this indicates that the required accuracy will not be achieved by the model. Depending on the frequency of these outliers, a surcharge will be levied for the calculation of the own-fund requirement. On the one hand, this will create an additional regulatory capital cushion, on the other hand, it will give the institution an incentive to improve the accuracy of its forecasts by adjusting its internal risk model. If the institution shows that an exception was not caused by inaccuracy in the risk model's forecasting, BaFin may disregard it.

Financial market crisis impairs accuracy of forecasts.

The extraordinary distortions on capital markets were reflected in a far higher number of backtesting exceptions among institutions. For 2008, institutions reported 120 outliers in total (previous year: 55). BaFin initially scrutinised these exceptions to assess the extent to which they were triggered by market distortions, which could not have been foreseen by the market risk models. Admittedly, instead of singular events occurring in the market over a period of several months, extreme market fluctuations occurred on a virtually daily basis over the course of the year. This means that it is possible that a fundamental change in market behaviour may have occurred which casts doubts on the assumptions and model parameters used to date. This has impaired the forecasting accuracy of risk models, which has been reflected in an increase in the number of backtesting exceptions. For reasons of caution, it seemed advisable to adopt a conservative approach in this situation and to ensure that institutions had sufficient capital. BaFin therefore demanded that institutions increase the quantitative additional factor to counter a temporary under-assessment of risk by the models in calculating the capital charge for regulatory capital adequacy.

Risk models are vulnerable to crises.

The distortions in the market have also illustrated the fact that even a good market risk model can only fulfil its role to a limited

extent in certain situations. This is particularly the case in the event of fundamental changes in market behaviour, especially as historical data and connections become less significant. Models cannot forecast structural changes of this kind. It is precisely under these conditions that it proves particularly worthwhile to support risk management with alternative instruments - such as stress tests. It is also essential that an institution's risk management team actively addresses existing potential losses and has a detailed understanding of its existing portfolio.

Table 19

### Risk models and factor spreads

Year	New applications	Withdrawn applications	Rejections	Number model banks	Minimum add. factor	Maximum add. factor	Median
1998	15	2	4	9	0,1	2,0	1,45
1999	5	0	0	8	0,1	1,6	0,85
2000	2	0	0	10	0,0	1,6	0,30
2001	2	0	0	13	0,0	1,5	0,30
2002	1	0	0	14	0,0	1,0	0,25
2003	0	0	0	15	0,0	1,8	0,20
2004	1	1	0	15	0,0	1,0	0,30
2005	2	1	0	16	0,0	1,0	0,25
2006	0	1	0	15	0,0	1,0	0,2
2007	0	0	0	15	0,0	1,0	0,2
2008	1	1	0	15	0,0	1,0	0,2

● Violations of supervisory law and sanctions imposed.

In 2008, there were 78 violations of supervisory law resulting in the imposition of sanctions (previous year: 94). The following table shows the distribution of the violations and sanctions across the individual groups of institutions:

Table 20

### Findings of supervisory law violations and sanctions imposed

Institution type	Serious findings	Measures against managing directors	Administrative fines	Measures in case of danger (section 46 KWG)
Lending institutions	13	1	0	1
Institutions in the savings banks sector	12	0	0	0
Institutions in the cooperative sector	37	2	0	1
Other institutions	11	0	0	0
<b>Total</b>	<b>73</b>	<b>3</b>	<b>0</b>	<b>2</b>

### Sub-prime Task Force

In response to the intensification of the financial market crisis, BaFin deployed its "Sub-prime Task Force" at the beginning of 2008. The role of the task force is to act as the central point of contact within BaFin for all queries in connection with the financial market crisis and to coordinate overlapping issues associated therewith. Members of the task force come from all departments, which supervise major banks or bank groups and from the relevant basic-issues and cross-sectoral departments. This mix of

backgrounds ensures that the task force has extensive expertise and guarantees that knowledge is transferred between the organisational units affected in an ideal manner.

In 2008, the central role of the task force was to analyse the causes of the financial market crisis using BaFin's extensive data and findings and to draw lessons from this for making the necessary improvements and enhancements to the supervisory rules. The task force's activities also focused on collecting information of relevance to the crisis for the decision-makers within BaFin and the Federal Ministry of Finance (BMF). Information was collected in close collaboration with the Bundesbank. To take account of the increased need for information, BaFin had to initiate individual measures, since the standardised supervisory reporting system was only able to satisfy the requirements of crisis management to a very limited extent:

- At the start of 2008, for instance, supplementary notification obligations on solvency and the earnings situation as well as particularly risky asset classes were introduced for banks of relevance to the system, in particular.
- The encroachment of the crisis from sub-prime securitisations to securitisations in general and then to virtually all asset classes also required many ad hoc surveys on a vast array of risks. On the basis of this information, BaFin was able to observe changes in the individual institutions' risk situation in real time and – if necessary – intervene.
- BaFin also introduced standardised daily liquidity reports for major German credit institutions from September against the background of the intensification in the crisis.
- In addition, daily "liquidity calls" were established with these banks so that BaFin and the Bundesbank are also informed of current developments on the interbank market and can react accordingly. As the liquidity position at most institutions has increasingly eased, the frequency of these enquiries has, as a rule, been reduced to once a week.
- Finally, the crisis also meant that a broadly based system of data collection had to be established, which included virtually all German credit institutions. In this connection, BaFin used appropriate questions to obtain information on banks' securitisation position or their solvency and earnings situation in the last quarter of 2008.

## 2.5 IRBA and AMA application procedures

● Option to use Principle I ceased to apply in 2008.

Up until the end of 2007, institutions were able to use Principle I in determining their regulatory capital requirements. Since 1 January 2008, all institutions have had to use the procedure prescribed in the Solvency Ordinance (SolvV) to calculate their regulatory capital requirements. As a result, many institutions calculated an amount required for operational risk for the first time in addition to the amounts required for counterparty risk and for market risk in the year under review.

### Counterparty risk

● 48 institutions use IRBA process.

At the end of 2008, 48 institutions and groups of institutions used internal rating systems and classification procedures for securitisation items (IRBA process) to calculate their regulatory capital requirements for counterparty risks. At the same time, two institutions used the so-called internal model method to calculate counterparty risk. Of the 48 IRBA institutions, 19 belong to the lending banks category and 14 to the category of other institutions. The other eleven institutions are members of the savings banks sector and four are members of the cooperative sector. Around half of all IRBA institutions have been authorised to use the advanced IRBA approach, use of which was allowed under SolvV for the first time as at 1 January 2008. As part of the approval process, BaFin confirmed the suitability of some 450 internal rating systems and classification procedures for securitisation items in total.

● Further applications for approval have been made.

BaFin and the Bundesbank carried out many suitability follow-up audits in 2008. Follow-up audits aim to ensure that any weaknesses in IRBA systems identified as part of the authorisation audits are rectified promptly. The audit activities of BaFin and the Bundesbank also continued in 2009. At the 2008 year-end, BaFin had received a further 20 letters of intent and applications to have IRBA systems approved.

### Operational risk

● Eleven AMA institutions in total.

In 2008, a further institution was authorised to use the advanced measurement approach (AMA). This meant that at the year-end, a total of eleven institutions and groups of institutions used an advanced measurement approach. BaFin was responsible for the authorisation process as "home supervisor" in six cases and as "host supervisor" in five cases. Two further authorisation processes are planned in 2009. Of the eleven institutions and groups of institutions that may use the AMA, seven institutions belong to the lending banks category and one institution to that of other institutions. The savings bank sector is represented by two institutions and the cooperative sector by one.

● 57 institutions use a standard approach.

In the year under review, 57 institutions used a standard approach, of which two institutions were authorised to use an alternative indicator in the standard approach. Use of the standard approach failed to meet BaFin's expectations. In previous surveys, some 130 institutions had declared their intention to use the standard approach. However, the other institutions use the so-called basic indicator approach.

● Further audits at AMA institutions.

In the case of some institutions using AMA, BaFin carried out follow-up audits in 2008. Various procedural improvements were identified in these audits. However, there remains scope for improvement, particularly, in the areas of business environment and internal control factors, the allocation process and validation. No additional follow-up audits are planned for 2009.

● Management of operational risks required, irrespective of the approach.

Implementation of suitable risk management systems which institutions can use to identify, assess, monitor and manage their operational risks is more important than choosing an appropriate approach for determining the amounts required. This requirement is already applicable from MaRisk and consequently applies to all institutions regardless of the approach selected. For institutions, which use a standard approach or an AMA, the qualitative requirements for the management of operational risks set down in the SolvV also apply.

### Management systems for operational risks

In the year under review, BaFin held discussions on the management of operational risks with some associations and institutions which use a basic indicator approach. The aim of this investigation was firstly to identify which procedures are used to manage operational risks. Building on this, practical standards were to be developed for interpreting the principle-based MaRisk requirements for the management of operational risks which take account of institutions' size and complexity. The function of the planned management systems is to gather, accumulate and evaluate information on operational risks and losses incurred systematically. With the help of these data, decision-makers may then decide on any measures that may be necessary.

The institutions included in the investigation all use loss databases and analyse the operational risks to which their areas of business are exposed. Various collection methods are used depending on the size of the institution. These range from a central analysis of operational risks by risk controlling or the Management Board to holding structured interviews or workshops in the individual areas of business. A considerable proportion of the institutions – particularly those in the cooperative and savings banks sectors – make use of external loss data gathered in other institutions to analyse the loss data. This is also true of the group of public sector banks which mostly use a standard approach. AMA institutions must, at any rate, use external data for risk analysis. Use of external data can result in a marked improvement in risk management, in that weaknesses in procedures and systems, possible human error and threats from outside can be recognised before considerable losses occur in the institution.

● Four audits of liquidity risk models.

### Liquidity risk

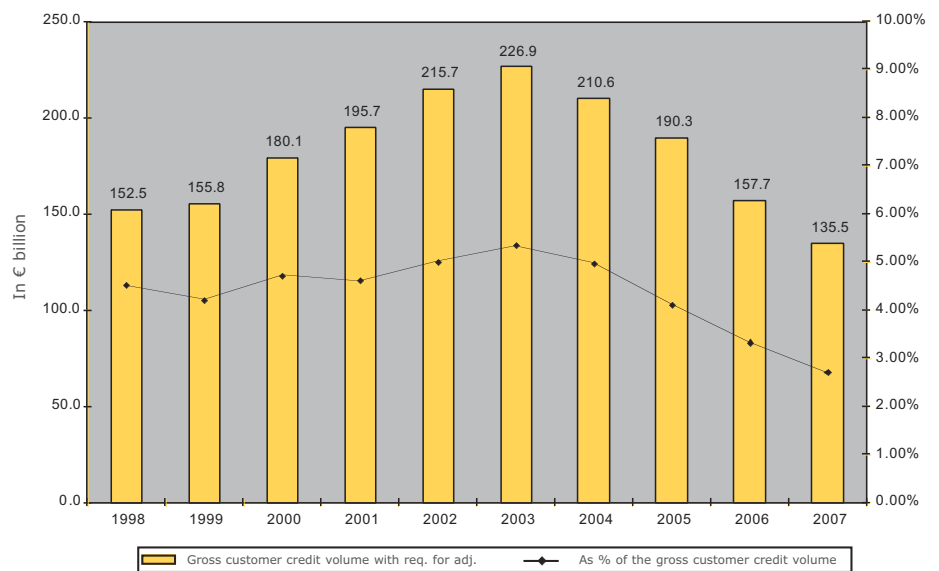
The Liquidity Ordinance (Liquiditätsverordnung – LiqV), which came into force in January 2007, allows institutions to use their own, internal risk assessment and risk management procedures (risk models) to demonstrate that they have sufficient liquidity once these have been checked by BaFin (section 10 LiqV). Audits to approve internal risk models of this kind were started at four institutions in 2008.

## 2.6 Non-performing loans

NPL volume falls 14%.

In 2007, the gross client lending volume requiring specific allowances, as analysed by BaFin, declined for the fourth time in succession. This figure, which is aggregated on the basis of individual banks' annual reports can be interpreted as an approximation of the volume of non-performing loans in German banks' portfolios. This results in a figure for non-performing loans (NPL) of €135.5 billion in 2007, equating to a reduction of 14% on the comparable figure in the previous year. The NPL percentage of the overall gross client lending volume decreased further and stands at 2.7% in 2007, compared with 3.3% in the previous year.

Figure 15  
NPL market potential\*



\* The audit reports relating to the 2008 financial statements were not yet available to BaFin in full at the time of going to print.

Financial market crisis could revive NPL market.

The easing evident on the NPL market is likely to still be largely attributable to the positive macroeconomic growth in 2007, which has contributed to an improvement in credit quality. While, in particular, the sale of NPL to international financial investors contributed significantly to the reduction in NPL volumes in credit institutions' balance sheets from 2003, transaction activity slowed markedly in 2007. However, the financial crisis and the associated slowdown in macroeconomic growth could provide new impetus for the NPL market. In future, particular attention will be concentrated on so-called leveraged loans. It is to be expected that some companies purchased by private equity investors and subsequently over-leveraged may no longer be support their accumulated interest burden. The resulting non-performing loans are likely to reinvigorate NPL transaction activity in Germany.



## 2.7 Financial services institutions

722 financial services institutions provided securities services.

As at 31 December 2008, a total of 722 financial services institutions were under BaFin's supervision (2007: 724), of which 82 were domestic branches of foreign companies (2007: 73).

It can issue a licence to provide investment and contract brokering services and/or to offer portfolio management services. Since the FRUG came into force in November 2007, investment consultancy, securities placement services and trading on one's own account are also financial services for which a licence is required. Investment consultancy is the provision of personal recommendations relating to transactions in certain financial instruments. Securities placement services cover cases where financial instruments are placed on the market and for which a licence was already required as a sub-category of contract brokering. Subject to more stringent capital requirements, BaFin may also issue a licence to conduct financial commission business. Own account trading does not represent a service in the absence of a third party but is put on a par with financial services under the KWG. Own account trading covers the purchase and sale of financial instruments for one's own account if these transactions take place without being based on a customer order.

As at 31 December 2008, 191 of the financial services institutions supervised by BaFin only conducted investment and contract brokering services as well as investment consultancy (2007: 132). 509 had a licence to offer portfolio management services (2007: 519) and 40 to offer securities placement services. As was the case last year, four of the financial services providers were authorised to obtain possession or ownership of customers' funds or securities. 23 financial services providers were allowed to trade in financial instruments for their own account (2007: 27).

125 applications for a licence to provide financial services.

In the year under review, 125 companies applied for a licence to provide financial services (2007: 68); 26 applications related purely to investment consultancy. 31 financial service providers applied for an extension to their licence (2007: 17), of which 24 cases related to securities placement services.

One reason for the increase in applications for licences is the fact that a licence is now required for investment consultancy and securities placement services. However, in this regard, account should be taken of the fact that all previously licensed credit and financial services institutions had automatically received a license to offer investment consultancy services as a consequence of a transitional regulation.<sup>25</sup> Investment consultancy services can also be provided without a licence if the consultancy only relates to fund units; there was previously and there will continue to be an exception of this kind solely for the brokerage of fund units. The new requirement for a licence for those offering investment consultancy services will only affect those consultants who advise customers in return for fees without brokering financial instruments at the same time.

<sup>25</sup> See 2007 Annual Report, p. 139.

● Financial crisis leads to a slump in earnings.

Financial services institutions are also feeling the repercussions of the financial crisis. Many institutions had to face sharp falls in earnings in 2008. As a rule, they generate income from sales commission and management fees for their customers' safekeeping accounts under management. In particular, the losses suffered by many customers' safekeeping accounts as a result of the general market development have also substantially reduced many institutions' earnings, particularly at the end of the period under review. BaFin monitors the financial situation of institutions very closely in order to be able to react promptly should an institution get into financial difficulties.

● Restructuring measures as a result of the flat rate capital gains tax.

The introduction of the flat rate capital gains tax in January 2009 has prompted some financial services providers to restructure their business models. Several institutions have suspended individual asset management for their customers. Instead they have launched investment funds with the help of an investment company, for which they assume the management role. Institutions sell units in these funds to their customers. The background to this is that fund managers will, in future, be able to buy and sell securities for a fund in future without the fund incurring income that is liable to flat rate tax. In contrast to this, gains on purchases and disposals are to be taxed as part of individual asset management.

● Numerous contractually tied agents under liability.

### Contractually tied agents

In addition to the financial services institutions, some 50,000 freelancers acted as contractually tied agents in distributing financial instruments for approximately 180 institutions. Contractually tied agents may be both freelancers and companies. They do not hold their own licence pursuant to section 32 KWG although they provide services for which a licence is required. Instead, they provide investment consultancy services, investment and contract brokering services and/or placement services as securities services under the liability ceiling of a licensed financial institution or securities trading company. Institutions must notify BaFin electronically of the agents for which they assume liability. The agents' activity is attributed to them and they bear full responsibility for their activities under supervisory law. This is advantageous to investors: in the event of loss – caused by having been misadvised, for instance – they can claim against the liable company in addition to the contractually tied agent. If an agent violates the statutory provisions, BaFin will approach the liable institution.

Since the FRUG has come into force, BaFin may prohibit a liable company which fails to select or monitor its contractually tied agents correctly from working with the agent. Therefore, before working with an agent, an institution must examine its reliability and specialist skills. In fact, most liable companies have already carried out checks of this kind in the past without any explicit, statutory obligation to do so. However, this new statutory obligation will make it far more difficult for non-professional participants to enter the market.

Public register of contractually tied agents creates transparency.

On 1 January 2008, BaFin introduced a public register of contractually tied agents on its homepage.<sup>26</sup> The register will make the capital market more transparent, since customers will be able to check the liable company for which the agent is working. If an agent is not listed in the register, he may not provide any securities services without obtaining his own licence. The respective liable companies, which can access the register directly online, are responsible for ensuring that entries are accurate and up-to-date.

A contractually tied agent may only work for a liable company. If an institution wishes to work with an agent, it can check in the register whether the agent is already working under the liability and for the account of another company.

### Cooperation

Working group meeting with the Bundesbank and annual discussion with IdW.

In 2008, the annual working group meeting between BaFin and the Bundesbank looked at the newly introduced statutory definitions, namely investment consultancy, securities placement services and own-account trading. In addition, they considered the public register and adapting the risk matrices of institutions supervised by BaFin to the new statutory requirements. It was the 21st working group meeting of this kind.



The annual discussion with the WpHG working group from the German Institute of Chartered Accountants (Institut der Wirtschaftsprüfer – IdW) took place in October 2008. Participants discussed the new Ordinance on the Examination of Investment Services Enterprises (Wertpapierdienstleistungsprüfungsverordnung – WpDPV) and chartered accountants' initial experiences with the new statutory requirements resulting from the FRUG coming into effect. A revision of the audit standard no. 521 on the auditing of securities services was also discussed.

### Risk-oriented supervision

In the year under review, BaFin also revised the criteria for classifying financial services institutions' risk on the basis of the extension in the duty of good conduct resulting from the FRUG. The risk matrix now includes assessment fields on the newly introduced regulations, for instance, on advertising, best execution and clarification of rebates. The scope of the risk matrix was extended at the same time: in future, the risk matrix will include all institutions supervised under the WpHG, i.e. both financial services and financial institutions, with regard to codes of conduct. Previously, only those institutions which have provided investment or contract brokering services or portfolio management services were included. Since classification of the institutions was not complete when we went to press, depiction in a risk matrix has not been possible.

<sup>26</sup> [www.bafin.de](http://www.bafin.de) » English Version » Databases & lists » Other databases.

Changes to the KWG and WpHG were the focal point of the supervisory consultations.

### Audits and measures

In 2008, BaFin monitored 39 audits at financial services institutions and held 130 supervisory consultations with managing directors or members of management boards. The monitoring of audits and supervisory consultations may be carried out for a specific reason or randomly and, as a rule, involve solvency and market supervision issues.

The personal contacts promote communication between the institutions and BaFin and facilitate rapid clarification of outstanding questions. In the year under review, many companies utilised this option to obtain information on statutory changes to the KWG and the WpHG. The monitoring of audits also allows discussion with auditors as to how they should carry out a particular audit and structure the audit report. In individual cases, monitoring the audit may replace a special audit. This is of benefit to the institution since unlike a special audit, additional costs are incurred in monitoring the audit.

48 licences revoked...

During the year under review, 48 licences held by financial services institutions were revoked, in most cases as a result of being returned.

...and six licences withdrawn by BaFin.

BaFin withdrew the licences of six financial services institutions.

The withdrawal of two licences related to portfolio managers who did not have the requisite regulatory capital and were facing insolvency. In one case, the institution repeatedly breached provisions of supervisory law and was not prepared or not in a position to make the requisite organisational arrangements to provide services in an orderly manner. The managing directors and one shareholder were not reliable either. The shareholder, who held a qualified participating interest in the institution, had returned his own licence to provide financial services in 2006 following a hearing on revoking his licence. The public prosecutor's office found against the managing director for deception, among other things.

BaFin withdrew the licence from one institution, which primarily sold so-called penny stocks to British and Irish customers, following a previous hearing. In addition to various organisational shortcomings and the infringement of reporting and notification obligations, the company had failed to explain the risks of the financial instruments it bought and sold sufficiently to its customers in the past. The institution's attention had been drawn to the existing shortcomings on several occasions in the past. As early as the start of 2008, BaFin had forbidden the institution from operating on a cross-border basis in other neighbouring European countries because of its organisational shortcomings.

BaFin withdrew the licence from two further institutions with international ties because there was evidence that the shareholders and the managing directors were unreliable. The managing

directors had tried to conceal the origin of inflows of funds to the institution in question and the beneficial owners of the institutions.

BaFin withdrew the licence from one institution after insolvency proceedings were initiated against the assets of the institution. Initiation of insolvency proceedings is always grounds for revoking the licence. An institution may no longer provide financial services once insolvency proceedings are initiated since the business's powers are transferred to the liquidator, who is not authorised to provide financial services.

● Three warnings due to organisational shortcomings.

BaFin issued three warnings. BaFin warned one institution that it had not taken sufficient organisational steps to deal with conflicts of interest within the group. The institution had made recommendations to several customers, which led to risk being too concentrated in customers' safekeeping accounts. On the one hand, it sold its customer shares in its parent company and, on the other hand, various funds. The institution acted as an investment consultant for these funds and also arranged to buy shares in its parent company. The WpHG also demands that the type and origin of any conflicts of interest in the group are thoroughly explained to customers.

Another institution was warned because it had frequently breached reporting and notification obligations under the KWG over a considerable period of time. In recent years, it had also failed to carry out the requisite audits of the annual financial statements and checks of its securities business in accordance with section 36 WpHG on time. Furthermore, the reports required with the audits were either not submitted at all, or not submitted on time. In the past, BaFin and the Bundesbank had drawn the institution's attention to its statutory obligations and warned it to comply with them on a number of occasions.



In November 2008, BaFin warned a third institution that its business was not properly organised. Its regulatory capital had fallen below the statutory minimum levels but the management had not reacted. The institution had also breached various notification obligations and submitted its annual financial statements very late despite its precarious business position. This weighed particularly heavily since prompt and complete returns and reports are particularly important for institutions which are being squeezed financially. They allow BaFin an overview of the current capital situation as this is the only means by which BaFin can take the necessary measures at short notice.

● One special audit pursuant to section 44 KWG.

An external auditor carried out a special audit of one financial services institution on behalf of BaFin. This was prompted by the company's impending insolvency and over-indebtedness. Since the institution had not informed BaFin of its capital situation, a special audit was needed to obtain the requisite information. The audit showed that the institution did not have sufficient regulatory capital to meet its payment obligations. Insolvency proceedings were initiated following the special audit; the institution is no

longer permitted to provide financial services. Consequently, BaFin revoked the institution's licence.

## 3 Market supervision

### 3.1 Credit institutions and financial services institutions

#### Credit institutions

In its supervision of savings banks and cooperative banks, BaFin focused on the implementation of the Markets in Financial Instruments Directive. In monitoring audits, BaFin paid greatest attention to how institutions have implemented the provisions on best execution of customer orders.

In December 2008, BaFin held a workshop with the Landesbanks where it discussed current issues relating to the role and position of compliance officers. Each securities services company must appoint an officer, who is responsible for the compliance function and its organisation. This officer must ensure that the company itself and its employees comply with the obligations of the WpHG. Among other things, discussions focused on personnel and resources and the independence of the compliance function, for instance, through its rights and powers.

In 2008, BaFin ordered a credit institution to undergo a special audit for a specific reason. The annual audit reports had repeatedly contained the same serious findings with regard to compliance with the code of conduct and had raised the question as to what efforts the institution had made to rectify shortcomings. BaFin wished to know, for instance, how the findings of the audit were communicated to the specialist areas affected and the responsible management levels. It also checked which actions had been taken to achieve a sustained improvement in quality and how they are monitored. One criterion for this is whether responsibilities within the credit institution are shared appropriately and whether the various management levels are included. The audit disclosed marked failings in the rectification shortcomings and the monitoring thereof in previous years but showed that following the announcement of the special audit by BaFin, the institution had made serious efforts to deal with the findings of the audit on a permanent basis. The management board of the institution in question set up a comprehensive project specifically for this purpose, in which the individual sales units for securities services participated in addition to representatives from compliance and internal audit. The future annual WpHG audits will show the extent to which the quality of securities services will actually improve in the long term.

● Focus on: MiFID and Compliance.

● One special audit pursuant to section 35 WpHG.

● Sale of Lehman certificates.

The collapse of the Lehman Group also affected many German investors. Many investors approached BaFin to complain about the respective institution that had sold them certificates. They had reportedly followed a recommendation from their bank and had not been correctly informed of the risks involved. Furthermore, many investors also stressed that they had asked for a secure investment. BaFin looked into each of these cases and, in particular, asked for the records of the investor's financial circumstances prepared by the bank, his investment targets as well as his knowledge and experience.

Admittedly, the records required under the WpHG only give an extract of the investment consultation. Accordingly, it is not clear from the records who initiated the consultation, what the customer's actual wishes at the beginning of the consultation were, how the consultation then proceeded and how long it lasted. For instance, with regard to the question as to how the consultation actually came about, many investors stated that they had been actively approached about Lehman certificates with regard to fixed deposits falling due or credit balances on current accounts. Many investors also said that their advisors had quantified the risks listed in the product descriptions. Even if BaFin – unlike a civil court – is unable to take any binding decision on behalf of the investors affected and their banks as to which presentation matches the events that actually occurred, these complaints gave BaFin vital details of possible misdeeds on the part of the institutions involved. BaFin therefore also subjected the sales process of the banks in question to intense scrutiny in addition to checking each investor's complaint.

Key questions in this connection were the target group to which Lehman certificates were sold, what proportion of the investor's assets the certificates accounted for and whether customers had previously acquired other certificates. BaFin also questioned whether the product descriptions gave an adequate presentation of the risks to which customers were exposed, which indicators – particularly after the sub-prime crisis started – were used in addition to the rating to assess the issuer's creditworthiness and how this was included in information for customers. Finally, the question arose as to which of the institution's offices were involved before new products were actively marketed and how the institution guaranteed that only products that investors could understand and which offered an appropriate risk/reward ratio were marketed.

BaFin will re-evaluate all the documentation that has been submitted to it in 2009 and will instigate any additional steps that may be necessary, such as special audits.

### Financial services institutions

● BaFin carried out regular audit itself.

In the year under review, BaFin did not carry out any special audits in accordance with section 35 WpHG at financial services institutions. However, as was the case with credit institutions, the companies had to undergo an annual audit with regard to their

obligations in terms of rules of conduct and organisational obligations under section 36 WpHG. In principle, audits are carried out by chartered accountants appointed by the respective institution. In one case, BaFin carried out the regular annual audit of securities services itself. Despite being warned on numerous occasions, the institution had not appointed any auditors, so BaFin was forced to carry out the audit itself. It is authorised to do this in individual cases.

### Exemptions from audits

BaFin granted 46 credit and financial services institutions exemption from the requirement to perform an annual audit in accordance with section 36 WpHG (2007: 49). An exemption may be granted if an audit does not appear necessary in light of the type and scope of the business activity. 21 exemptions related to credit institutions, consisting of 19 savings banks and cooperative banks and two private banks. There were 25 exemptions granted to financial services institutions. BaFin also granted 13 credit institutions exemption from the requirement to audit their safe custody business (2007: 24). The continued reduction in the number of new exemptions is attributable to the fact that most institutions have now made use of the existing options for exemption. In principle, the exemption is granted in the form of ongoing administrative acts which set a specific audit frequency over several years. This has the advantage that institutions that have been exempted do not need to re-apply once an audit has taken place.

### Experiences with the FRUG

The FRUG celebrated its first birthday on 1 November 2008. From BaFin's viewpoint, the switch to the new regime has been a success. It has now received the first audit reports from credit and financial services institutions on working with the new law; the reports are currently being evaluated.

In July 2007, BaFin set up a working group to discuss questions of interpretation with the associations affected, with the aim of finding joint, practical solutions. The working group's experiences were included in the circular on monitoring employee transactions, for instance. In the year under review, BaFin received 46 queries from institutions, auditors, lawyers or investors (2007: 252).

### Best execution (section 33a WpHG)

The FRUG obliges securities services institutions to execute their customers' securities orders in the best possible manner. In principle, this obligation relates to all financial instruments and consequently includes securities orders in equities, bonds, debentures, certificates and other derivative securities. The sole exception under current administrative practice are orders in investment fund units. However, section 33a WpHG does not oblige

46 institutions exempt from the annual audit under WpHG.

Circular on the monitoring of employee transactions.



securities services institutions to achieve the best possible result for their customers when executing a single securities order. Instead, securities services institutions only have to create appropriate organisational preconditions in order to consistently and frequently achieve the best possible result in executing their customers' securities orders. In this connection, securities services institutions are obliged, in particular, to draw up so-called execution principles. According to the statutory requirements, the execution principles must, among other things, contain detailed information on the trading centres at which their customers' securities orders may be executed. The securities services institutions have to be guided by statutory criteria in devising their execution principles and in selecting suitable trading centres. The total fee for executing orders constitutes the crucial criterion in executing private customers' orders.

● Market survey on execution principles.

In 2008, BaFin carried out a market survey of selected institutions to establish whether the institutions which it supervises have made appropriate organisational arrangements to satisfy their obligation under section 33a WpHG. Among the vast majority of the institutions, the content of the majority of the execution principles is plausible and they were drawn up in accordance with the criteria stipulated in section 33a WpHG.

However, differences were apparent in the methodology used by the institutions in devising their execution principles and in selecting the trading centres. While most companies opted for the so-called static model and route incoming securities orders to pre-defined execution centres, only a few market participants offer the so-called dynamic model and decide which trading centre will offer the best possible result for each order when it is received.

Differences are also apparent in the information content and the degree of differentiation in the execution principles. For instance, the majority of the institutions do not specify the trading centres by name but instead a reference to execution on a German stock exchange suffices. Trade in certificates continues to be settled as a fixed price transaction although a marked increase in the turnover of certificate trading on stock exchanges has been evident for some time.

In some cases, the credit institutions' principles do not make it sufficiently clear that securities orders are routed via a third-party institution. Before selecting a third-party institution, credit institutions must check how far this institution's execution principles are appropriate for its own business model, its own customer structure and the typical securities orders placed by its own customers. Some institutions had made no arrangements to regularly review and monitor the execution principles of third-party institutions used by them.

● New trading centres do not yet play a role when in terms of execution principles.

Although new trading centres such as Chi-X and Turquoise have emerged since November 2007 and are competing with established stock exchanges, this has not yet been reflected in institutions'

execution principles. Most credit institutions also continue to route their private customers' securities orders involving DAX stocks to Xetra for execution. It remains to be seen to what extent and when the new framework conditions will influence the choice of trading centres.

● Advertising the focus of supervision.

Since institutions needed information on the new advertising regulations in the year under review, BaFin discussed the new guidelines with companies, lawyers and representatives from academia in a workshop. BaFin has included the findings from the workshop in its administrative practice. It is planning a supervisory memorandum for 2009 which is designed to provide the institutions with information on interpreting the advertising provisions.

If advertising is directed at private customers, the possible benefits of an investment may only be stressed if attention is drawn to possible risks at the same time. The company placing the advertisement may not use incomprehensible wording for important statements or warnings and may not weaken them; comparisons within an advertisement must be meaningful and balanced. Advertisements referring to changes in the gross value of a financial instrument must also include details of the impact of commission, charges and other fees.

● Five new administrative offence proceedings against banks and financial service providers.

#### **Fine proceedings**

In four cases (2007: 2) BaFin imposed fines of up to € 51,710 in the year under the review. Three of these proceedings were based on breaches of the prohibition on cold calling. A further case related to an infringement of the reporting requirements duties contained in section 9 WpHG. In total, BaFin initiated five new administrative offence proceedings against banks and financial services institutions in 2008 (2007: 4). Ten cases were still pending from the previous year (2007: 10). Seven cases were dropped (2007: 2), of which two were discontinued because they were not in the public interest. Four cases were still pending at the end of the year (2007: 10).

### **3.2 Rules of conduct with regard to financial analysis in analysing financial instruments**

During economically challenging times especially, investors seek wide-ranging advice before deciding on investments. Financial analysts are possible sources of advice. They examine individual companies or entire sectors against the background of their position in the capital market and make recommendations on investments.

### Credit and financial services institutions

At the end of 2008, BaFin supervised 463 credit and financial services institutions which prepared their own analyses or acquired analyses prepared by third parties and made them available to their customers or disseminated them publicly (2007: 471). The focus here was concentrated on credit institutions; financial services institutions featured only very rarely as the authors or publishers of analyses.

● Questions of interpretation regarding the FRUG.

Compliance with the provisions of the WpHG on financial analysis is monitored by auditors as part of their annual audit of institutions' securities services. BaFin evaluates auditors' audit reports and requests additional information from the auditors or the institutions, if necessary. No serious shortcomings were identified in the year under review. At many institutions, however, implementation of the FRUG led to many questions on interpretation.

● Extreme downgrades to price targets are not generally inappropriate.

In investigations of individual cases BaFin analysed how financial analyses are prepared and presented. Having been somewhat rare in recent years, "sell" recommendations featured more frequently in the year under review. Contrary to the assumption by some capital market participants – in particular, some issuers directly affected by financial analyses – analyses, which contain extreme downgrades to price targets, are not generally to be viewed as inappropriate. If an analyst uses up-to-date, publicly known and plausible corporate data and recognised corporate valuation methods, his findings – such as a further economic deterioration with a substantial risk of insolvency – cannot be objected to simply because they do not concur precisely with other analysts' assessments.

● Analyses produced abroad.

At credit institutions with global operations, the practice has developed of allocating Europe-related analyses from a single office in the group, from London, for instance, across Europe. Accordingly, the German subsidiary or branch is then no longer involved in the preparation or distribution of financial analyses. For BaFin this means that analyses produced abroad and distributed from there no longer fall within its supervision.

### Independent analysts

In the year under review, BaFin monitored 123 persons, who were not employed by any institution and had registered their work as analysts in accordance with section 34c WpHG (2007: 114). Some of these are individuals whose business operations are not extensive but others are larger, well-known analysis companies. There is no legislation providing for an annual audit by chartered accountants for this group of analysts. BaFin has therefore obtained information and requested documentation on a case-driven basis to monitor requirements in terms of competence, transparency and organisation. If this revealed shortcomings, BaFin pressed to have these rectified. In individual cases, market letters suspended their operation in the course of investigations by BaFin.

“Buy” recommendations increasingly evident for commodity stocks.

In the first half of the year, “buy” recommendations were increasingly evident from market letters on commodity stocks. Often these involved companies listed for OTC trading with only a narrow market, which were extremely positively assessed in a few market letters. If the person who makes the recommendation has conflicts of interest – because the analysis was paid for by third parties or he holds the financial instruments he is recommending himself, for instance – then he must disclose this. If such references or even the imprint are missing, by implication an objective recommendation cannot be expected. Rather, investors are advised to be extremely cautious. This is also the case if the market letter is sent on an unsolicited basis, for instance by e-mail. In cases of this kind, BaFin not only checks whether a financial analysis was prepared with the requisite technical knowledge, care and diligence, but also whether there are any signs of illegal market manipulation.

#### Media

Financial analyses are often disseminated via the media, for instance in the context of stock market reports on radio and television. In addition, many publishers of market letters or newsletters make their investment recommendations as part of their journalistic activities.

If representatives of the media can show that they are subject to effective self-regulation, they will not be subject to supervision by BaFin. The Press Code of the German Press Council (Deutscher Presserat) is one of the established forms of self-regulation. Since the end of 2008, this has also encompassed editorial contributions in services that are exclusively available online.

#### Fine proceedings

Two administrative fine proceedings based on the suspicion of infringements of the rules of conduct with regard to financial analysis were pending at the beginning of the year under review. BaFin imposed an administrative fine of €6,000 in one of these proceedings. This was caused by a breach of the notification obligations under section 34c WpHG. A further case was therefore still outstanding at the end of 2008.

Administrative offence due to the breach of notification obligations.



Karl-Burkhard Caspari,  
Chief Executive Director for Securities  
Supervision

## VI Supervision of securities trading and investment business

### 1 Basis for supervision

#### 1.1 Prohibition on short selling

The global financial crisis which gripped the German financial sector in 2008 led to hefty losses on the international stock exchanges and considerable price fluctuations. Securities from banks, insurance companies and financial service providers in particular came under great pressure in the wake of investment bank Lehman Brothers' insolvency and the tense global situation at many major banks and insurance companies.

#### Short selling

Short selling is understood to be the sale of a security which the seller does not have in its portfolio. A distinction is made in this respect between covered shorts and naked sales/naked short sales. In the case of a covered short, the seller "lends" itself the security prior to selling. It thus obtains title to the security via securities lending. On the other hand, where naked sales are concerned, the seller sells the security without having title to it or a certain claim to transfer of shares of the same category at the time of the transaction; he must therefore procure it at a later juncture. This can lead to more securities being sold short than are available in total on the market.

BaFin prohibits naked short sales.

In the year under review, BaFin banned short selling for the first time in order to counter a threat posed to the stability of the German financial system. In its Decrees of September 2008, BaFin prohibited naked short selling of shares issued by eleven companies in the financial sector. The companies concerned are: Aareal Bank AG, Allianz SE, AMB Generali Holding AG, Commerzbank AG, Deutsche Bank AG, Deutsche Börse AG, Deutsche Postbank AG, Hannover Rückversicherung AG, Hypo Real Estate Holding AG, MLP AG and Münchener Rückversicherungsgesellschaft AG. In December BaFin extended the ban, which was initially limited to the end of 2008, to 31 March 2009 and then again to 31 May 2009.<sup>27</sup>

<sup>27</sup> www.bafin.de » Supervisory legislation » Orders Securities supervision » General Decrees of 19 and 21 September 2008 as well as of 17 December 2008 and 30 March 2009.

The restrictions not only apply to shares in the financials concerned, but also to other financial instruments, such as put options or short certificates for instance. However, such instruments may still be bought and sold. The current practice of hedging resulting risk positions by short selling shares is no longer possible for newly issued products. The ban on short selling is exclusively intended to prevent naked short sales. Short selling is especially likely to further exacerbate excessive price movements on markets which are highly volatile as a result of the financial crisis. This endangers financial system stability and can lead to substantial disadvantages for the financial market. The prohibition also intends to prevent market manipulation of the securities concerned. The ban thus safeguards properly executed trading and contributes to fair pricing on the stock markets.

● Short selling restricted worldwide.

America's Securities and Exchange Commission (SEC) and Britain's Financial Services Authority (FSA) also restricted short selling. Furthermore, more than 15 other supervisory authorities restricted short selling, referred to existing bans on short selling, or introduced duties of disclosure for short sell positions. These include Australia, Canada, Hong Kong and Japan in addition to many EU Member States. There is a general ban on naked sales in Switzerland. Moreover SIX Europe, based in London, issued a market order extending the FSA's ban to Swiss companies listed in the United Kingdom. The SEC and FSA lifted their prohibitive regulations in October 2008 and January 2009 respectively, but retained their duties of disclosure for short selling. However, other countries such as France or Italy also extended their bans.

● Demand for more regulation.

The financial crisis also led to a rethink as regards securities supervision: whereas talk was previously of further deregulation, politicians and supervisory authorities at national and international level are now discussing steps towards stricter regulation. The intention is for financial markets to be more transparent and private investors better protected. The general downward slide in prices, but in particular the insolvency of Lehman Brothers and the resulting losses incurred by certificate holders, means that the matter has now been placed on the political agenda for clarification.

The draft bill on national reform of bond legislation approved by the Federal Cabinet on 18 February 2009, for example, already makes provision for measures to improve investor protection: in future it should be possible to prove cases of negligent advice more easily as a result of the planned obligation to draw up a record of the content of investment advice and provision thereof to the customer. Furthermore, where compensation claims for negligent advice are concerned, the three-year period of limitation should only start when the customer is aware or could have known of the negligent advice. The maximum period of limitation should be ten years from the time of the negligent advice. The special short period of limitation of three years from the time the claim arises has applied to date; the customer's knowledge has no bearing.

## 1.2 Risk Limitation Act

The aim of the Risk Limitation Act (Risikobegrenzungs-gesetz), most parts of which came into force on 19 August 2008, is to counteract unwanted activities by financial investors. Amongst other things, the act provides for increased transparency in the case of qualified participating investments in listed companies.<sup>28</sup>

The act amends the Securities Trading Act (WpHG) and the Securities Acquisition and Takeover Act (Wertpapiererwerbs- und Übernahmegesetz – WpÜG): from March 2009, the voting rights conveyed by other financial instruments have been aggregated with the voting rights from shares when calculating voting shares requiring notification according to section 25 WpHG, thereby making the structure of qualified participating interests more transparent. For example, under the new regulation it is no longer possible to add 4.99% of share options to 2.99% of directly held shares without informing the capital market thereof.

According to the newly introduced regulation contained in section 27a WpHG, from the end of May 2009 anyone acquiring a share of voting rights which is subject to notification requirements and which is above the 10% threshold must first inform the issuer of the origin of the funds used for the acquisition and the purpose of the acquisition. The act also sets out the legal definition of “acting in concert” contained in section 22 WpHG and section 30 WpÜG.

## 1.3 Venture Capital Investment Act

The Venture Capital Investment Act (Wagniskapital-Beteiligungsgesetz – WKBG), promulgated on 18 August 2008 as part of the Act on the Modernisation of Framework Conditions for Venture Capital and Equity Investments (Gesetz zur Modernisierung der Rahmenbedingungen für Kapitalbeteiligungen – MoRaKG) is designed to encourage investment in fledgling and medium-sized companies.<sup>29</sup> The act governs the activities of venture capital companies and their recognition and supervision by BaFin. Tax benefits in MoRaKG provide incentives for venture capital companies to invest in new, unlisted companies with regulatory capital of less than €20 million. What is known as a suspensive clause applies to all MoRaKG’s favourable tax arrangements. In accordance with this clause, these regulations come into force on the day the Commission establishes their compatibility with the common market.

<sup>28</sup> 2008 Federal Law Gazette I, p. 1666.

<sup>29</sup> 2008 Federal Law Gazette I, p. 1672.

The act governs the activities of venture capital companies and their recognition and supervision by BaFin. In particular, BaFin must examine the company's Articles of Association, minimum capital contribution, suitability of the managers and a business plan before it can grant recognition. Analysing the annual audit reports, monitoring notification obligations in the event of amendments to the Articles of Association and market monitoring with regard to compliance with WKBG are just some of the important tasks that BaFin has to carry out in supervising venture capital companies.

## 1.4 Investment Audit Report Ordinance

With the Investment Audit Report Ordinance (Investmentprüfungsberichtsverordnung – InvPrüfbV) of 15 December 2008, BaFin has firmly established the subject matter and content of audits for investment companies and funds within the terms of the Investment Act (Investmentgesetz – InvG).<sup>30</sup>

The new InvPrüfbV replaces the Audit Report Ordinance for credit institutions which had applied previously. It contains regulations regarding the content of the annual audits of investment companies, funds and public investment companies, which are adapted to their particular circumstances. It also gives precise specifications regarding the auditing of annual, interim and liquidation reports for funds, details of which had previously not been firmly established.

Following the new ordinance, BaFin expects the quality of audit reports to improve and fewer wordings standardised by boilerplate text. Modern audit regulations provide BaFin with a deeper insight into corporate structures and products in the investment sector which are of relevance in terms of supervision. This improves the likelihood of BaFin being able to adopt a risk-orientated approach to crises and negative changes in the market. At the same time, the InvPrüfbV creates greater legal certainty for auditors and companies subject to supervision and can thus also lead to an improvement in quality of location.

## 1.5 Supervisory practice

### Circular on the Investment Act

In December 2008, BaFin published a circular on the application of the InvG to the distribution of units in foreign investment funds. Section 1 sentence 1 no. 3 InvG stipulates that InvG also applies to the public distribution of a unit in a foreign investment fund. The circular establishes BaFin's understanding of the InvG's scope of application with regard to distribution of such units in foreign

<sup>30</sup> 2008 Federal Law Gazette I, p. 2467.





investment funds which do not constitute EC investment funds within the terms of section 2 (10) InvG. The InvG applies to such non-directive-compliant funds if the units are in a foreign pool of assets issued by a foreign investment company where the investor can claim redemption of his units (section 2 (9) InvG). If the investor is not entitled to claim redemption of his units, the unit that does not comply with the directive still falls under the InvG if the foreign investment fund is subject to investment supervision in its country of domicile. BaFin decides whether a unit in a pool of assets is to be regarded as a unit in a foreign fund within the terms of section 2 (9) InvG and thus falls within the scope of the InvG as part of the notification procedure according to section 139 InvG. BaFin bases its decision on the contractual terms and conditions, the Articles of Association, the investment terms, or provisions comparable to these, and the sales prospectus – if this is available – and the applicant's written representations.

#### **Interpretative decision on the disposal of assets in the case of open-ended real estate funds**

At the start of February 2009 BaFin published an interpretative decision regarding the disposal of fund assets by the investment company during suspension of redemption of share certificates pursuant to section 81 InvG.<sup>31</sup> If an investment company suspends redemption of share certificates in a real estate fund, section 81 InvG then establishes various periods with regard to the action that companies may take the prescribed duties to act. The decision stresses that as soon as the first redemption suspension period has expired, investment companies are obliged to dispose of assets, if this is possible on appropriate terms, in order to procure the necessary liquid funds.

#### **Issuer guidelines**

In the year under review, BaFin revised and enhanced the content of its issuer guidelines published in 2005. The revised sections were primarily those relating to ad hoc disclosure, directors' dealings and information regarding insider registers. Notes on voting right notifications, enforcement and financial reporting obligations were new additions. The update was necessary to take account in particular of the regulations which have been amended and newly introduced by the Transparency Directive Implementation Act (Transparenzrichtlinie-Umsetzungsgesetz – TUG). The guidelines also take into consideration the latest case law and administrative practice, and are aimed at German and foreign issuers, whose securities are admitted to trading on a German stock exchange.

BaFin consulted on the draft for the revised guidelines with representatives of associations, companies and legal practices in January 2009. Final publication is scheduled for May 2009.

<sup>31</sup> [www.bafin.de](http://www.bafin.de) » Publications » Interpretative decisions (Securities supervision).

## 2 Monitoring of market transparency and integrity

### 2.1 Trading platforms

#### Multilateral trading facilities

● New area of competence: supervision of multilateral trading facilities.

BaFin has been monitoring multilateral trading facilities (MTF) since November 2007. There is an exception for stock exchange operators as operating an MTF. Like for the stock exchange itself, responsibility for the MTF lies with the respective federal state's stock exchange supervisory authority.

The characteristic feature with regard to the operation of an MTF is that it brings together the interests of multiple persons in buying and selling financial instruments within the system, and according to established provisions, in a way which leads to a contract for sale of these financial instruments.

Operating an MTF is both a financial service requiring a licence within the terms of the KWG (institutional supervision) and an investment service pursuant to the WpHG (system operation supervision). MTF operators must therefore meet all of the requirements for financial services institutions, in particular having reliable and professionally suitable managers and maintaining adequate levels of regulatory capital.

● Three applications for conversion.

Companies that were already permitted to provide investment brokering services as of 1 November 2007 were deemed to have been automatically authorised to operate a multilateral trading system. They had to submit a completed application for authorisation in accordance with section 32 KWG to BaFin by the end of January 2008. A total of three institutions made such an application. All three applicants now operate as multilateral trading facilities.

● Special obligations regarding conduct, organisation and transparency.

The regulations of sections 31f and 31g WpHG specify special obligations regarding conduct, organisation and transparency for multilateral trading facilities. As a minimum, operators must therefore regulate access requirements for traders as is provided for by the Stock Exchange Act (Börsengesetz – BörsG) for stock exchange trading. Regulations must also be laid down for the inclusion of financial instruments, proper trading and determination of prices, the use of inclusive reference prices and contractual transaction processing.

The trading facilities must have appropriate assessment procedures for monitoring price and trading regulations and the prohibition on insider trading and market manipulation. BaFin must be notified immediately of serious trading regulation violations and interference with market integrity. Seamless supervision should be ensured by records of orders and transactions concluded.

Operators must furthermore ensure that multilateral trading facility prices are established in the correct manner and correspond to the actual trading market. Notification of prices and turnover figures must be given immediately. Any information which is necessary and expedient for use of the MTF must also be publicly disclosed.

● Continuous publication of prices and volumes.

Comprehensive pre- and post-trade transparency obligations apply to multilateral trading platform operators. During normal hours of business they must continuously disclose information about shares and share certificates included in the system, for example. This information includes, most notably, the price of the highest limited buy order and the lowest limited sell order, and the volumes traded at these prices. In respect of the transactions concluded, information is to be provided – in real time whenever possible – about the market price, the volume and the time. BaFin may make exceptions. Details of the disclosure obligations are regulated by the Act Implementing the Markets in Financial Instruments Directive (FRUG).<sup>32</sup>

### Foreign trading screens

● Strong level of interest in setting up foreign trading screens.

Operators from foreign markets for financial instruments (which do not represent either organised markets or multilateral trading facilities under the WpHG) wishing to offer domestic traders direct electronic market access require a BaFin licence.

### Licence verification

Operators from foreign markets must make information and documentation available to BaFin for the licence. Pursuant to sections 37i (1) WpHG and the Market Access Information Ordinance (Marktzugangsangabenverordnung – MarktAngV) these include the names and addresses of the managers, the person authorised to receive service and the domestic traders to whom market access is to be granted. The competent supervisory authority in the country of origin and its competence to monitor and intervene must also be stated. It is an essential prerequisite for a licence that the competent supervisory authorities are able to exchange all of the information necessary for supervision of the foreign market. An informative business plan must also be submitted. From this it must be apparent how market access is to be provided, the financial instruments that are to be traded, and furthermore the internal control procedures that are in place.

<sup>32</sup> Ordinance (EC) No. 1287/2006, Chapter IV section 1, 3 and 4.

BaFin involves the stock exchange supervisory authorities from the federal states when reviewing whether a licence can be granted. The Supervisory Authority must refuse, rescind or withdraw the licence if there are indications that management is not reliable and market monitoring and investor protection in the home country are not on a par with German law, or if the market or its operator persistently breach legal provisions.

BaFin must announce the granting and rescission of the licence in the electronic Federal Gazette (Bundesanzeiger).

● Licence issued to the Dubai Stock Exchange.

At the end of 2008, three foreign market operators were licensed to offer German traders direct electronic access to markets. At the end of 2007, for example, BaFin allowed DIFX Dubai International Financial Exchange Ltd. to set up trading screens in Germany. In 2006, the Dubai Financial Services Authority DFSA and BaFin had already concluded an MoU, thereby ensuring the requisite exchange of information between the supervisory authorities. BaFin had received two more licence applications by the end of 2008.

BaFin offers preliminary audits to make the licensing process as rapid and smooth as possible. Many foreign market participants avail themselves of this offer. For instance, BaFin checks in advance whether the exchange of information required between the competent supervisory authorities for a licence to be granted is possible. This is regularly the case when signing bilateral MoUs and where the foreign supervisory authority is a signatory to the multilateral IOSCO MoU.

## 2.2 Market analysis

● BaFin analysed 440 background circumstances.

The 440 analyses (2007: 750) of suspected market abuses, in the form of insider trading or market manipulation, were frequently triggered by information from investors and companies (around 1,300). Compared to the previous year (almost 1,000), the number of such leads again rose by around 30%.

Numerous analyses were based on suspicious activity reports from banks (114; 2007: 101). As in the previous year, 67 reports related to suspicious share transactions. Warrants were involved in 30 cases (2007: 19). 17 suspicious activity reports were forwarded to BaFin from the competent foreign supervisory authorities (2007: 20). Leads from the stock exchanges' trading surveillance offices and enquiries from prosecuting authorities also played an important role.

Amended reporting requirements make monitoring the market more difficult.

BaFin analyses all securities transactions in order to ascertain suspicious transactions. Credit and financial services institutions must transmit this data to it. In 2008, BaFin received 859 million such records (2007: 935 million), i.e. around 2.4 million data records per day (2007: 2.6 million).



The lower figure compared to the previous year can be ascribed to the fact that the implementation of the MiFID fundamentally changed reporting in 2008. Those notifying parties from the rest of Europe who previously had to notify BaFin directly, now send their transaction data to their domestic supervisory authorities. These then forward the records to the supervisory authority for the country in which the most liquid market for the financial instrument traded is based. Records are exchanged via the European TREM system. In the year under review, BaFin received around 335 million records in this regard.

After being in place for a number of years, the reporting obligation for such securities – which are only traded OTC – lapsed and was not replaced. In selected, highly prioritised cases, BaFin requests reports from the warrant and certificate issuers, as well as from the stock exchanges' trading surveillance offices. This is done in order to at least partially fill in the gaps in these records. As a result, data procurement and analysis has become more laborious.

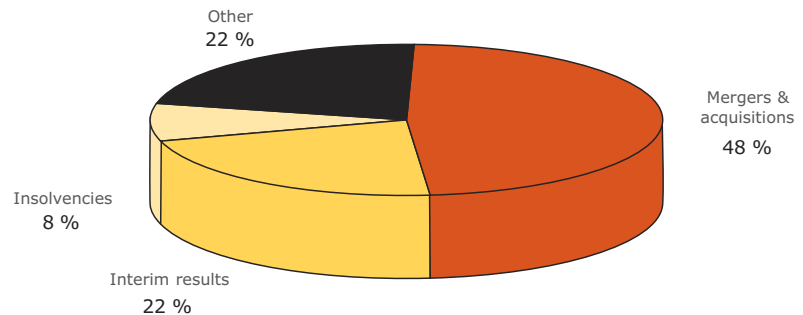
Analysis is much more risk-oriented.

Because background circumstances and the financial instruments in question are increasingly complex, the time taken per case increased further in the reporting year. The overall number of analyses fell accordingly, yet analyses where further investigation was recommended were less seriously affected: BaFin found indications of insider trading (37; 2007: 45) or market manipulation (29; 2007: 35) in 66 (2007: 80) of the total of 440 analyses conducted.

Almost 50% of all positive insider analyses concerned takeovers.

The majority of insider analyses concerned financial instruments traded on the regulated market. Just under 15% could be ascribed to OTC transactions. Almost half of positive insider analyses in 2008 related to corporate takeovers and mergers (18; 2007: 20). In comparison, transaction numbers increased in significance again (8; 2007: 9).

Figure 16

**Background of positive inside analyses**

- Sharp fall in manipulation via spam e-mails.

In the year under review, cases of positive market manipulation analyses largely involved sham activities (16; 2007: 17) – agreed transactions such as pre-arranged trades or “wash sales”, predominantly in less liquid securities.

Information offences, on the other hand, still represented a little over one third of all positive analyses (11; 2007: 17). This must be ascribed to the pressure for prosecution applied by criminal prosecutors and BaFin, as well as better informed investors. For instance, spam e-mails which were still booming in 2007, played practically no part in the reporting year. Due to falling stock market prices, the environment for driving share prices upwards by means of aggressive recommendations has also deteriorated markedly.

Figure 17

**Background of positive market manipulation analyses**

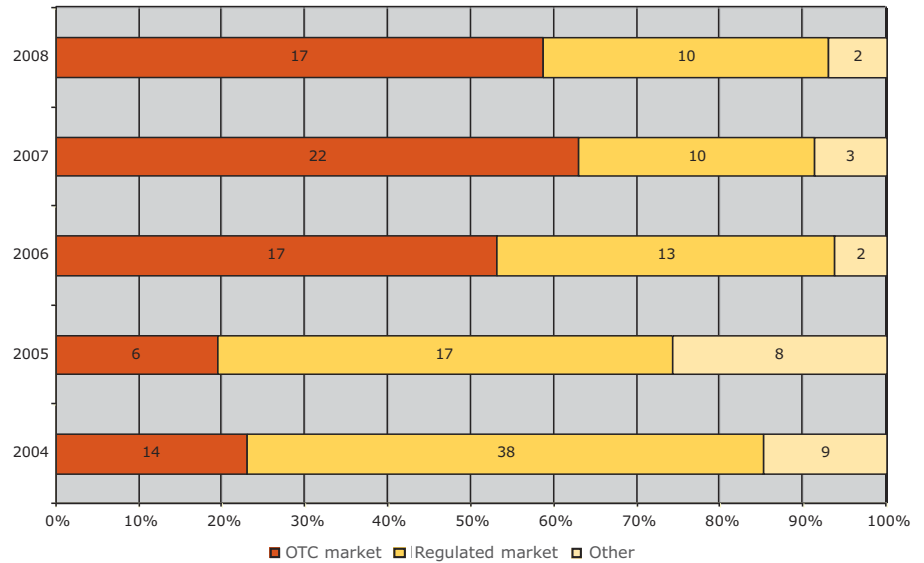
- Instances of manipulation in OTC trading remained high.

The significance of OTC trading for market manipulation remained consistently high. Almost 60% of positive analyses (17) related to OTC-traded shares.

In this regard, BaFin paid special attention to lead brokers, in other words specialist securities trading banks. It is these banks which typically apply for admission of shares to OTC trading and then subsequently also set the prices for these shares. They are therefore key to market integrity. Companies are still admitted to OTC trading first and then given massive buy recommendations by means of market letters, faxes or telephone calls. However, in most cases, within a very short time the result was hefty price

losses (pump and dump) rather than the price rise hoped for by investors. BaFin's investigations were still ongoing at the time this report went to print.

Figure 18

**Positive manipulation analyses by segment\***

\* Regulated market: 2004 to 2007 official and regulated market. The FRUG has removed the distinction between these segments and transferred the securities admitted there to the regulated market as of 1 November 2007.

BaFin informs investors.

BaFin not only notifies relevant cases to the public prosecutors, it also informs investors as a preventative measure and points out unfair market practices. In addition to the guidance on dealing with stock market recommendations from market letters and newsletters published in 2007, in the year under review, BaFin explicitly warned against the particular risks associated with OTC securities, from the USA, Canada and Switzerland, for example. These are used for manipulation purposes with particular frequency. BaFin furthermore published a consumer brochure on securities trading.<sup>33</sup>

## 2.3 Insider trading

Table 21

**Inside trading investigations**

Period	New Investigations	Results of investigation		investigations
		Pending	Dis-continued	
	Insider	Insider	Referred to public prosecutor's office	Total
			Cases	Persons
2006	51	23	24	106
2007	42	29	20	64
2008	44	54	27	67

<sup>33</sup> www.bafin.de » Publications » Brochures.

67 persons reported for insider trading.

In 2008, BaFin referred 27 cases to public prosecutors (2007: 20) on suspicion of insider trading, and filed complaints against a total of 67 individuals (2007: 64). It discontinued 54 cases (2007: 29) as the investigations did not reveal sufficient indications of insider trading.

BaFin opened a total of 44 new investigations into insider trading in the year under review (2007: 42). 62 cases, some from previous years, were still pending at the end of 2008 (2007: 99).

Exchange of information with foreign supervisory authorities.

In the year under review, BaFin received 33 enquiries from foreign supervisory authorities on matters relating to insider trading (2007: 36). Referrals from France, the Netherlands and Spain were particularly frequent. Conversely, BaFin approached foreign authorities 63 times (2007: 63), most often, as in previous years, Austria, Switzerland and the United Kingdom.

Table 22

#### Prosecutors' reports on closed insider proceedings

Period	Total	Discontinued	Discontinued after out-of-court settlement	Final court decisions			
				Decisions by the court	Convictions following summary proceedings	Convictions following full trial	Acquittals
2006	71	42	17	0	6	5	1
2007	82	65	14	0	3	0	0
2008	102	84	12	0	3	3	0

Six convictions for insider trading.

The courts convicted six people of insider trading in 2008 (2007: 3), three of which were after summary proceedings (2007: 3). State prosecutors dropped 96 cases (2007: 79), twelve of which were discontinued in exchange for an out-of-court settlement (2007: 14).

Some of the cases concluded in 2008 are described below.

#### EADS N. V.

On 13 June 2006, EADS N. V. issued an ad hoc disclosure about delays in delivery of the Airbus A 380. The statement asserted that the contribution to EBIT from the A 380 programme would be around €500 million per year lower for 2007 to 2010.

On 4 May 2006, aware of the deteriorating business figures, an employee of Airbus Deutschland GmbH – EADS N. V.'s lead contractor for the cabin interior – purchased 11,300 put options on EADS shares for €2,486. He sold these on 16 June 2006, making a profit of €8,362.

In July 2008, following payment of €6,910.68 pursuant to section 153a of the Code of Criminal Procedure (Strafprozessordnung – StPO), the Ravensburg public prosecutor's office dropped the case.



BaFin had filed complaints against other people on suspicion of insider trading. Investigations in this respect were still ongoing at the time of going to print or had been dropped on grounds of insufficient evidence.

### **DAB Bank AG**

On 13 February 2006, DAB Bank AG announced in an ad hoc disclosure that its provisional pre-tax result for 2005 was 48.2% up on the previous year.

Furthermore the board of directors planned to distribute the balance sheet profit in full with an 18% dividend. The price of DAB shares immediately rose by 9% to €9.10.

On 18 January 2006, an employee who had advance knowledge of the business figures, had already purchased 7,000 DAB shares at €6.70 for his wife's safekeeping account. He sold them again on 13 February 2006, making a profit of €12,900 in the process.

Munich Local Court convicted the defendant of insider trading and imposed a fine at a rate of 50 daily instalments of €50 each. The bank dismissed the employee for insider trading. The judgement has been res judicata since June 2008.



### **Arques Industries AG**

On 10 August 2005, the press reported that most of the regulatory capital of Arques Industries AG consisted of book transfer write-ups. The German Financial Reporting Enforcement Panel (FREP) examined the company's 2004 consolidated financial statement for breaches of accounting principles. It ascertained nine errors and informed Arques Industries AG of these at the end of August 2005. The company disclosed the errors in mandatory publications on 2 and 3 February 2006, whereupon the share price fell by 10% to €116.

An executive member of the company knew of the ongoing FREP investigation and the expected publication of errors. Between 13 September and 22 November 2005, he sold a total of 2,400 Arques shares, earning €148,251.60. The accused thus avoided a loss of around €3,700.

Munich Local Court convicted the accused, imposing a fine payable in 90 daily instalments of €40 each. The conviction has been res judicata since March 2008.

### **Premiere AG**

In an ad hoc disclosure of 8 February 2007, Premiere AG announced a new marketing contract with Arena Sport Rechte und

Marketing GmbH. According to this contract, Premiere AG would be able to distribute and market Bundesliga broadcaster Arena via satellite throughout Germany with immediate effect. Premiere AG would thus once again become Germany's biggest pay-TV marketer of Bundesliga football.

On 7 February 2007, the accused purchased 6,666 Premiere shares for a total of €100,489 and immediately sold them again after the disclosure for a profit of €17,200. In the course of the public prosecutor's investigations the accused admitted having obtained the insider information from a person within Premiere AG.

The Landshut public prosecutor's office dropped the case against the accused in July 2008 following payment of €12,000 pursuant to section 153a StPO.

#### **4mbo International Electronic AG**

In an ad hoc disclosure dated 25 February 2004, 4mbo International Electronic AG stated that it has ended the 2003 financial year with a big operating loss. On 27 February 2004, the company further announced that its board of directors was to file for bankruptcy with Esslingen Local Court.

As early as the start of February 2004, a company employee had begun to offload his 4mbo shares. He managed to sell 109,000 of his total of 220,000 shares. He issued the final order for his remaining shares one hour before the ad hoc disclosure of 27 February 2004. It was only possible to partly execute the order, however, as the quotation was suspended following the disclosure.

The employee avoided a loss of more than €29,000 as a result of his sales. As revealed by the investigations of the Stuttgart public prosecutor's office, the employee was informed of impending events and therefore constituted an insider.

As a result of the accused's admissions the public prosecutor dropped the case in November 2008, pursuant to section 153a StPO, in return for an out-of-court settlement of €15,000.

#### **Court rulings on the publication of documents**

On 6 November 2008, Frankfurt Administrative Court ruled that under certain circumstances, employee e-mails are not subject to telecommunications secrecy.

BaFin had requested documents, including e-mails, from a company as part of an insider trading investigation. The claimant company pleaded that the e-mails requested by BaFin were protected by telecommunications secrecy and could not, therefore, be surrendered. As the company's mail system was also made available for private purposes, the employer was providing the employees with a telecommunications service and therefore had to comply with telecommunications secrecy.

The Administrative Court dismissed this plea. According to Federal Constitutional Court case law, telecommunications secrecy protects private telecommunications and guarantees their confidentiality. The protection ceases, however, at the instant the recipient receives the message and the transmission process ends. If, after transmission, the employee decides not to delete the e-mails, but to store them on the company PC system, he is not due any protection from telecommunications secrecy for an unlimited period of time.

At the time this report went to print, a decision by Hesse Administrative High Court on the motion to allow the appeal was still pending.

## 2.4 Market manipulation

77 new market manipulation investigations.

In the year under review, BaFin commenced a total of 77 new investigations, 25% more than in the previous year (61). In addition to positive internal analyses, the investigations were increasingly triggered by specific enquiries from public prosecutors or police forces, as well as suspicious activity reports from banks. BaFin also received numerous referrals from the stock exchanges' trading surveillance offices. Referrals from the trading surveillance offices were particularly frequent regarding manipulations assisted by trading such as sham transactions, agreed transactions, or reference price manipulations.

64 reported for market manipulation.

BaFin found evidence of a criminal breach of the ban on market manipulation in 32 cases (2007: 22). It therefore reported 64 suspected persons to the appropriate public prosecutors (2007: 49). The Supervisory Authority dropped 42 investigations (2007: 41). At the end of the year, 100 investigations were still pending (2007: 97).

Table 23

### Market manipulation investigations

Period	New investigations	Results of investigation						Pending investigations
		Discontinued	Referred to public prosecutor's office or BaFin administrative fines sections			Total (cases)	Total	
			Prosecutor		Admin. fines section			
			Cases	Persons	Cases			Persons
2006	60	30	15	38	5	6	20	103
2007	61	41	22	49	4	8	26	97
2008	77	42	32	64	0	0	32	100

Focus on scalping.

Most of the market manipulation investigations in the year under review concerned what is known as "scalping", during which the suspect first purchases a share or another financial instrument and then makes a recommendation without making adequate reference to his existing conflict of interests.

Joint-stock companies, most of which were incorporated or renamed only very recently, are frequently floated for this purpose. Due to the comparatively low transparency requirements, the perpetrators consciously choose the OTC market so as to make it difficult for investors to obtain further information about the company. The companies are then given massive buy recommendations via market letters, calls, or spam e-mails. Prices and turnover increase considerably as a result of the recommendations, which is exploited by the perpetrators to sell the previously acquired shares at a profit. If the shares do not receive further recommendations, in most cases the prices collapse within a very short time.

BaFin has investigated many such scenarios and referred eight cases of suspected market manipulation to the public prosecutors. During one investigation the public prosecutor, the Federal Criminal Police Office (Bundeskriminalamt), several regional criminal police services and BaFin searched more than 20 business premises and private residences and seized extensive evidence.

Cross-border manipulation continues to increase.

As in previous years there was an intensive exchange of information in 2008 between BaFin and foreign supervisory authorities. Foreign supervisory institutions officially requested help from BaFin with market manipulation investigations on 14 occasions (2007: 18). BaFin asked for help from abroad in 43 cases (2007: 42). These requests primarily concerned details of customers who had traded in a suspicious manner on a German stock exchange via a foreign institution. BaFin is noting increasing levels of cross-border manipulation in the German market.

Table 24

**Prosecutorial and court reports, and reports by the internal administrative fines section concerning closed market manipulation proceedings**

Period	Total	Decisions of public prosecutors		Final court decisions in criminal proceedings			Decisions in administrative fines proceedings	
		Discontinued	Discontinued after out-of-court settlement	Convictions following summary proceedings	Convictions following full trial	Acquittals	Discontinued	Final administrative fines
2006	15	6	4	3	1	0	0	1
2007	18	11	0	2	2	0	3	0
2008	23	12	5	2	3	0	1	0

Five convictions for market manipulation.

There were five convictions for market manipulation in 2008, three of them following full public trials (2007: 2 and two after summary proceedings (2007: 2). During the year under review, the public prosecutors brought charges in four other suspected cases referred by BaFin. The trials in these cases are still pending. The public prosecutors dropped 17 cases they had launched (2007: 11), five of which were discontinued in return for an out-of-court settlement.

BaFin still has eight administrative fine proceedings for attempted market manipulation pending from previous years, one of which it discontinued in 2008. Seven cases were thus still pending at the end of the year.

Below is a selection of cases concluded in 2008, and investigated by BaFin for market abuse.

#### **MusicMusicMusic Inc.**

Between May and August 2005, a German private investor traded shares in MusicMusicMusic Inc. on the Berlin-Bremen, Frankfurt and Stuttgart stock exchanges. In the process he used his own safekeeping account and four other safekeeping accounts belonging to members of his family and friends, over which he held power of attorney. In 78 cases he achieved artificial stock exchange prices as a result of matching buy and sell orders. Following a systematically recurring pattern, the investor limited the orders placed so that these were always to his advantage and to the disadvantage of other parties involved. Accordingly, he purchased the shares cheaply for his own safekeeping account and sold them again a little while later to the other parties at a higher price. As a result, he made a profit of €4,480, whilst the other securities accounts incurred losses of between €420 and €1,665.

In January 2007, Neustadt Local Court found the investor guilty of 78 cases of market manipulation, issued him with a warning and imposed a total fine of 50 daily instalments of €20 each. The sentence has been res judicata since January 2008.

#### **sportwetten.de AG**

In August 2003, Hamburg Regional Court ordered sportwetten.de AG to refrain from offering customers from Germany the opportunity to gamble for money, against which the company appealed. This appeal was dismissed by Hamburg Higher Regional Court in August 2004. A judicial review was not permitted.

Due to the serious repercussions of the judgement on the earnings situation of sportwetten.de AG, the latter would have been obliged under section 15 WpHG to immediately inform the capital market of the court order by means of an ad hoc disclosure. The company concealed the information it had a duty to disclose, though, until 26 November 2004, thus affecting the share price and preventing a fall in prices.

In August 2008, Munich Local Court ordered an executive member of sportwetten.de AG to pay a total fine of €35 per day for 90 days. The public prosecutor originally petitioned for a fine of 90 daily instalments of €60 each day. The defendant appealed against the fine imposed. The sentence has been res judicata since August 2008.

### Call warrants on Pfitzer Inc. shares

Between 3 and 21 October 2005, two members of the board of directors of a Swiss company placed 112 orders for Deutsche Bank call warrants on Pfitzer Inc. shares on the Stuttgart stock exchange. They coordinated the timing, limiting and volume of these orders such that they were executed against each other and resulted in 56 artificially generated stock prices. In so doing, one of the accused acted via the Swiss company's safekeeping account, the other via his personal safekeeping account. The personal safekeeping account thus made a profit while the corporate safekeeping account incurred a loss.

Stuttgart Local Court ordered both defendants to pay fines of €130 and €40 per day respectively for 250 days. The summary judgments have been res judicata since December 2007 and January 2008 respectively.

## 2.5 Ad hoc disclosure and directors' dealings

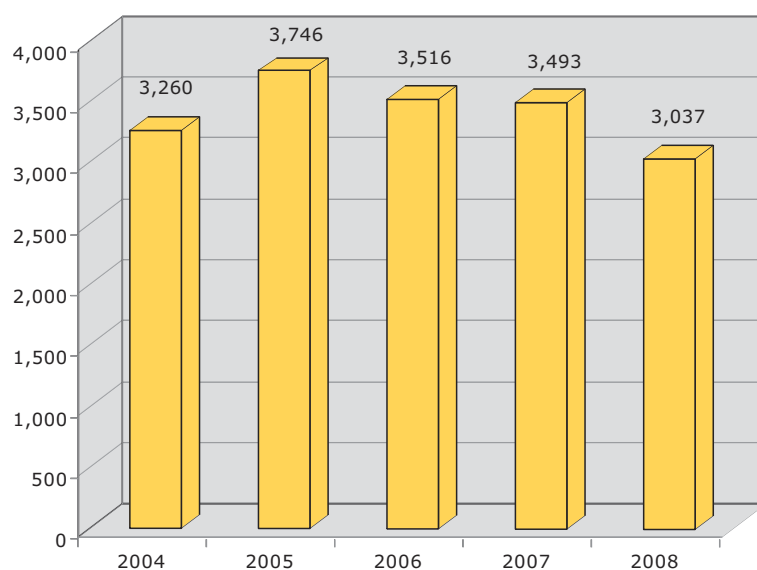
### Ad hoc disclosure

● Companies published 3,037 ad hoc disclosures.

Listed companies published 3,037 ad hoc disclosures in 2008, a good 13% fewer than in the previous year (3,493). One reason for the decline is likely to be the falling number of corporate transactions subject to ad hoc disclosure.

Figure 19

### Ad hoc disclosures (2004 to 2008)

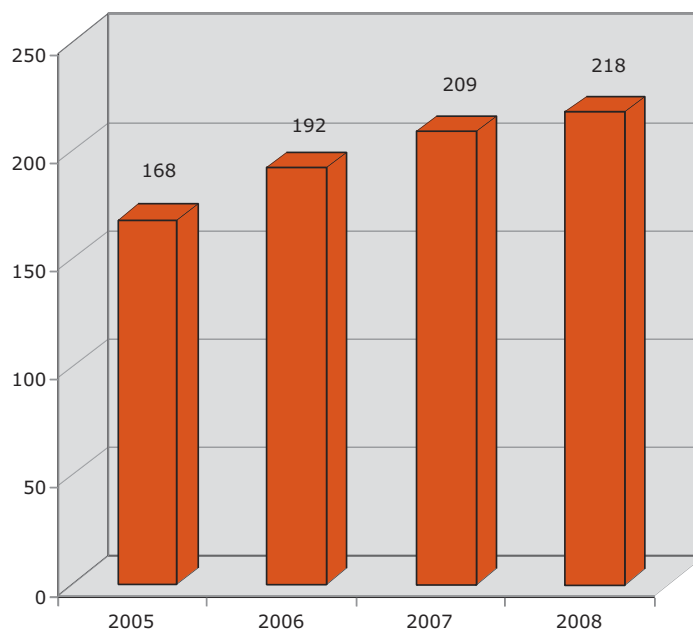


The concept of the domestic issuer was introduced when the Transparency Directive Implementation Act (Transparenzrichtlinie-Umsetzungsgesetz – TUG) came into force. Since then, ad hoc disclosure pursuant to section 15 WpHG has only been compulsory for domestic issuers. Basically, domestic issuers are issuers whose home country is Germany. Both the concept of the domestic issuer and that of the home country have thrown up a multitude of questions and problems of definition, especially in the context of the country in which the security is admitted to trading, the nature of the organised markets and the type of financial instrument. BaFin has worked hard to clarify these.

However, the number of cases in which companies exempted themselves from immediate publication of insider information continued to rise slightly (218; 2007: 209).

Figure 20

**Exemptions (2005 to 2008)**





The further increase in exemptions shows, on the one hand, that exemption is a tool with which issuers have quickly become very familiar. On the other hand, it may also be possible to ascribe the increase to a situation arising for an increasing number of issuers – brought about by a change in the macro-economic environment – which justified exemption from the duty to immediately disclose ad hoc announcements. During the year under review, in addition to the exemption option, BaFin increasingly discussed with companies issues regarding the ad hoc duty in the event of no shares being admitted for trading on an organised market, for example, but only bonds.

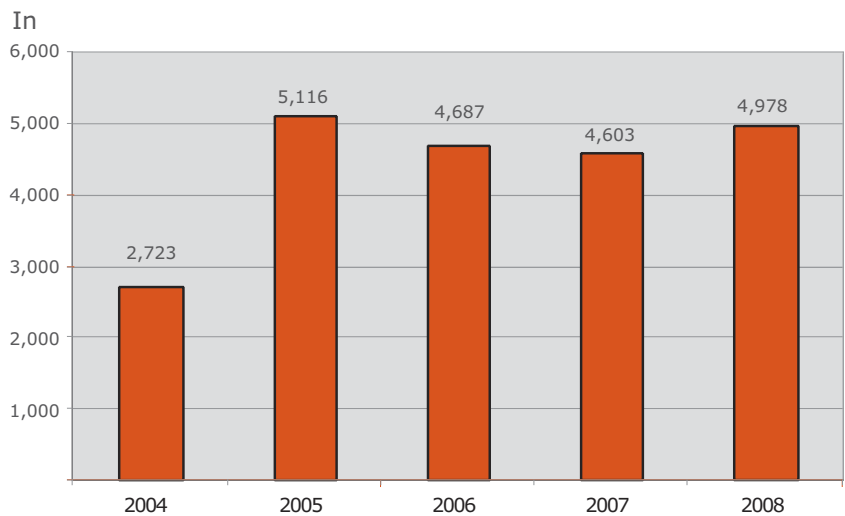
BaFin punished five breaches of the ad hoc disclosure duty.

BaFin imposed five fines of up to €70,000 (2007: 7) because companies failed to disclose insider information in a timely manner, disclosed information that was incomplete, incorrect, or simply did not disclose information at all. Criminal sanctions for market manipulation were imposed in three cases that BaFin referred to the competent public prosecutors.

22 cases were dropped (2007: 15), eight of them because they were not in the public interest (2007: 9). 42 cases were still pending at the end of the year (2007: 52). BaFin opened at total of 20 new cases (2007: 8). 52 cases were still outstanding from the previous year (2007: 66).

**Directors’ dealings**

Figure 21  
**Directors’ dealings reports (2004 to 2008)**



More directors’ dealings due to the flat rate capital gains tax.

2008, the boards of directors and supervisory boards of listed companies, and their employees, reported 4,978 dealings in shares of their own company (2007: 4.603). As a result, reports rose again for the first time in two years. This must essentially be



ascribed to the introduction of the flat-rate German capital gains tax with effect from 1 January 2009. Shortly before the end of 2008, managers bought large volumes of securities in their own companies and reported 1,300 transactions in December alone. The financial crisis, however, did not lead to managers reporting large-scale sales in 2008.

All securities transactions which were disclosed less than one year ago are collated in a database on BaFin's website.<sup>34</sup> At the same time, all securities transactions conducted by managers are also available in the Company Register, the central platform for storage of company data.<sup>35</sup>

Two breaches of the duty to report directors' dealings.

In the year under review, BaFin imposed two fines of up to €16,000 on company insiders who breached their reporting duty (2007: 10).

It opened a total of seven new cases (2007: 5). Nine cases from the previous year were still outstanding (2007: 24). BaFin discontinued five cases (2007: 10) because none of them were in the public interest (2007: 7). Nine cases were still pending at the end of the year.

## 2.6 Voting rights and obligations to provide information to securities holders

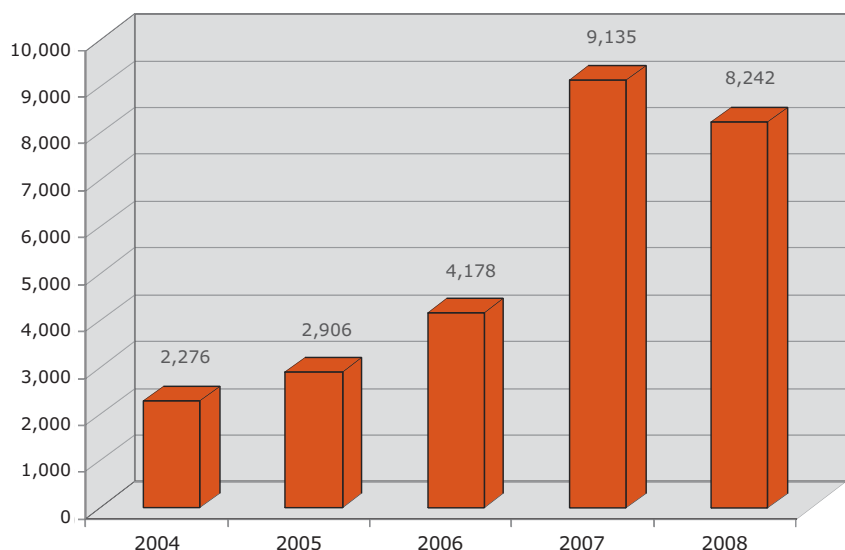
### Voting rights

Slight fall in voting rights reports.

In 2008, BaFin was notified of somewhat fewer changes to voting rights (8,242) than in the previous year (9,135).

Figure 22

### Voting rights reports (2004 to 2008)



<sup>34</sup> [www.bafin.de](http://www.bafin.de) » Datenbases & lists » Other databases.

<sup>35</sup> [www.unternehmensregister.de](http://www.unternehmensregister.de).

BaFin received 31 reports concerning financial instruments (2007: 23). Issuers disclosed 494 changes to their share capital with voting rights (2007: 559).

The number of issuers admitted to trade on a regulated market fell slightly to 1,026 (2007: 1,045). As was the case last year, only two REITs were listed on German stock exchanges. They have been subject to notification requirements in respect of their voting rights since 2007.

Reporting duties for financial instruments settled purely in cash.

The takeover of Continental AG by the Schaeffler Group and turbulence in the price of Volkswagen ordinary shares in October 2008 increased public focus on WpHG reporting requirements. The matter in question was primarily whether changes in percentages were notifiable in the case of financial instruments settled purely by cash. As the writers of such financial instruments directly or indirectly hedge their risk positions by means of physical deposit of the underlying instrument, the extensive acquisition of such financial instruments may bring about a liquidity squeeze in the underlying instruments or be used to hedge the against takeover of another company's share positions, without the need for disclosure.

For instruments which are only settled by cash, such as cash-settled options or swaps, the holder is not, however, entitled to actually subscribe to the share as the underlying instrument. Instead he receives a monetary sum. Changes are not notifiable in accordance with the current legal situation.

#### Aggregation of voting rights and financial instruments

Voting rights arising from sections 21, 22 WpHG and voting rights that can be acquired via financial instruments are counted together as of March 2009. This material change in the disclosure obligations can be ascribed to the Risk Limitation Act.

If a company – which already holds, and has reported, 6% of voting rights – acquires financial instruments granting it the right to another 4.5% of voting rights in the same security, this was not subject to notification requirements under the previous legal situation. The newly added 4.5% did not give rise to a notification requirement under section 25 WpHG. Now, however, according to new legislation, the company's total of 10.5% exceeds the 10% threshold. As this threshold had not yet been notified pursuant to sections 21, 22 WpHG, the company must issue a notification according to section 25 WpHG.

If the company had only purchased 3% via the financial instruments, this would have come to a total of 9% and there would have been no notification requirements under either the previous or the new legal situations.

If the company were to purchase another 2% of voting rights according to section 21 WpHG, it would not have had to notify this

according to the previous legal situation either. The company would, in fact, then merely hold 8% under sections 21, 22 WpHG and 3% under section 25 WpHG. According to the new legal situation, on the other hand, the a notification on the part of the company would have been necessary, pursuant to section 25 WpHG: the total share of voting rights would then be 11% and the 10% threshold would have been exceeded.

The impact of the new regulation on transparency becomes clear if one looks at the initial threshold value of 5%: previously, it was possible to jointly hold up to 2.99% of the voting rights and up to 4.99% via financial instruments without incurring a reporting obligation according to sections 21, 22 or 25 WpHG. Under the new legal situation, the maximum is now just 2.99% of voting rights and 2% via financial instruments.

- Eleven fines imposed for breaches of reporting duties.

During the year under review, BaFin commenced 228 proceedings (2007: 29) because of delayed, incorrect, incomplete or missing disclosures of changes in voting right percentages. The reason for the rise was the new Risk Limitation Act requirements, which resulted in more incorrect notifications. In four cases BaFin imposed fines of up to €16,000 (2007: 11). 38 cases were still pending from previous years (2007: 37). BaFin dropped eleven cases (2007: 17), ten of which because they were not in the public interest (2007: 15). 251 cases were still pending as at the end of 2008 (2007: 38).

#### Obligations to provide information to securities holders

- Obligations to provide information pursuant to sections 30a – g WpHG.

Issuers of authorised securities must inform BaFin if they intend to change their legal basis. This is the case where amendments are made to the Articles of Association or those legal bases that affect the rights of the securities holder. What is meant are the legal bases relating to securities other than shares, such as the terms for authorised bonds. BaFin received 342 such notifications in 2008 (2007: 606).



Furthermore, issuers reported changes in the rights associated with authorised securities, acceptance of bonds and disclosure of important information in non-member states 30,197 times (2007: approximately 15,000). With effect from summer 2008, the duty of disclosure in Germany, as in other EU/EEC Member States, is limited to those bonds which are authorised on an organised market. Originally, it also covered non-authorised bonds.

## 3 Prospectuses

### 3.1 Securities prospectuses

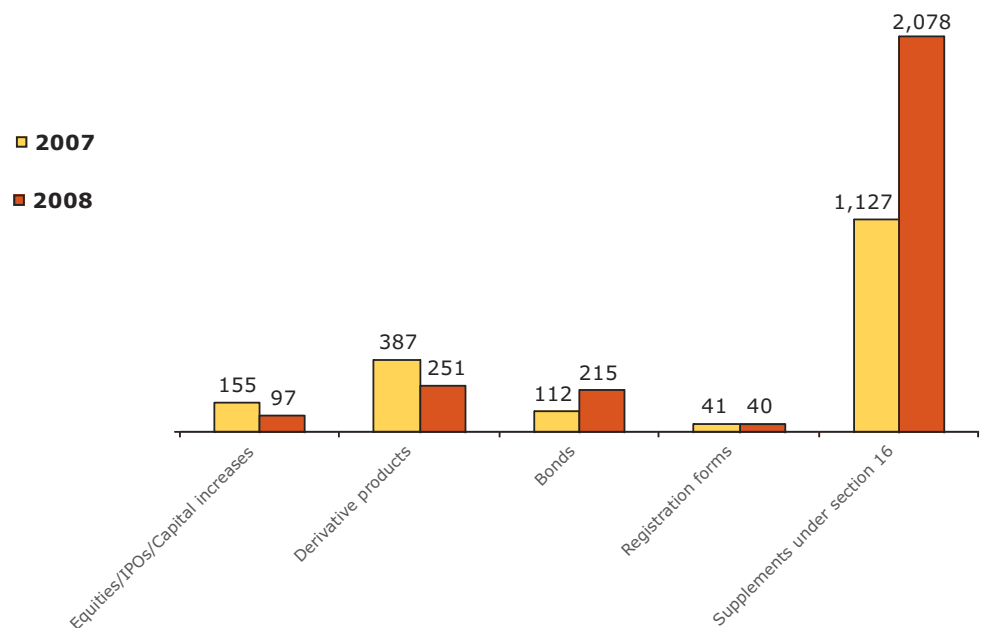
#### Prospectus examination

In 2008, BaFin approved a total of 2,681 securities prospectuses, registration forms and supplements to prospectuses, once again considerably more than in the previous year (1,822). It refused approval in seven cases. The number of prospectuses increased slightly compared with the previous year; the volume of issues and number of products offered, on the other hand, rose very markedly. This is because issuers frequently use base prospectuses which in turn can be used for multiple issues in the case of derivative products and bonds. Information about the issuers contained in the base prospectus can also be included in a separate document – the registration form. Issuers did this in 40 cases (2007: 41).

Further sharp increase in supplements.

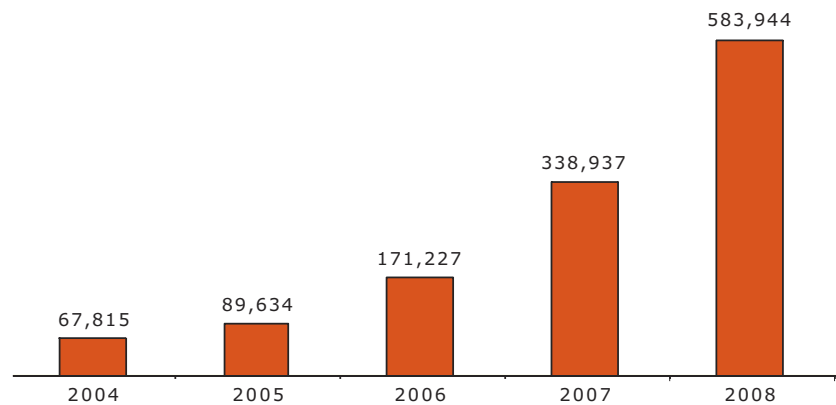
Figure 23

#### Approval reviews 2007 and 2008



The number of approved supplements doubled (2,078; 2007: 1,127): and even quadrupled compared with 2006 (456). However, the gloomy sentiment on the stock exchanges caused by the global financial crisis led to fewer prospectuses for IPOs and capital increases (97; 2007: 155) being submitted and approved. Prospectuses for derivative products also fell (251; 2007: 387).

Figure 24

**Total issue volume 2004 to 2008**

● 583,944 issues.

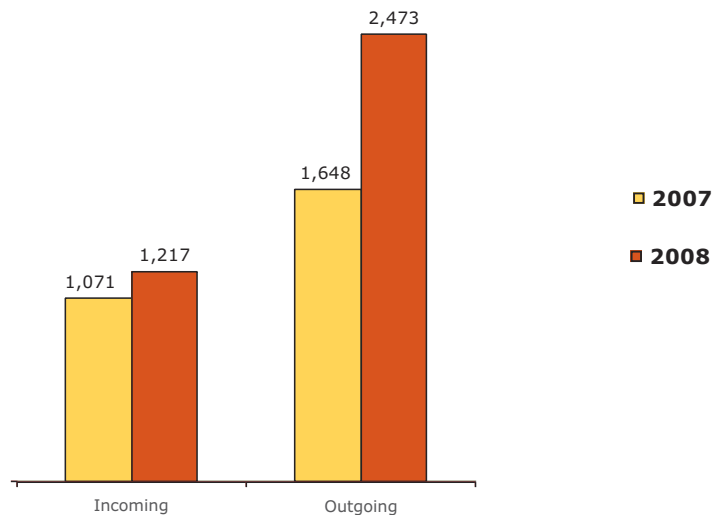
● European Passport very popular among both domestic and foreign issuers.

The total volumes of issues, based on full prospectuses, final terms and conditions and supplements according to old legislation rose by just under 60% to a total of 583,944 issues in 2008, continuing the trend of previous years. This can be attributed to the sharp rise in the number of base prospectuses issued, together with the accompanying final terms and conditions (583,771; 2007: 338,590).

In the year under review, BaFin provided notification for 2,473 prospectuses and supplements to the rest of Europe (2007: 1,648). Almost 50% of so-called Certificates of Approval went to Austria (1,125). Luxembourg took second place (559), followed by Italy (133), the Netherlands (105) and Sweden (86). Belgium (75) and France (67) more or less balanced each other out; the same applies to Norway (46) and Poland (43). Other outgoing notifications went to the United Kingdom (39), Finland (34), Denmark (31), Liechtenstein (29) and the remaining EEA Member States (101).

The number of issuers from European Member States submitting notifications of their prospectuses and supplements to Germany also increased (1,217; 2007: 1,071). Around 45% of notifications were received from Luxembourg (536), 299 from the United Kingdom, 177 from Ireland, 150 from the Netherlands, 27 from Austria and 22 from France. Six incoming notifications came from other European Member States.

Figure 25

**Incoming and outgoing notifications 2007 and 2008**

Three fines imposed.

BaFin took action on six new cases of suspected breaches of the Securities Prospectus Act (Wertpapierprospektgesetz – WpPG) (2007: 6). Eight other cases from the previous year were still pending (2007: 21). In three cases fines of up to €9,000 were imposed (2007: 1), and one case was dropped (2007: 21). Ten cases were still pending as at the end of 2008 (2007: 8).

Expiry of regular issuer privilege for savings and cooperative banks.

**Expiry of regular issuer privilege**

The so-called regular issuer privilege expired at the end of 2008. Up until this point, most notably savings banks and cooperative banks could publicly offer bonds and comparable, transferable securities without a prospectus if the corresponding securities had been issued on an ongoing or repeated basis. Public offers, which were launched without a prospectus in 2008, may not be continued in 2009 without a prospectus. Accordingly, the credit institutions concerned endeavoured to publish securities prospectuses as early as the second half of the year in order to be able to maintain public offers beyond 31 December 2008.

As an exception, credit institutions are permitted to continue offering non dividend-bearing securities without a prospectus if the securities are issued on a permanent or repeated basis, if the sale price for all securities offered within twelve months amounts to less than €50 million and if the securities exhibit certain features.

BaFin workshop for regular issuers.

BaFin contacted the respective banking associations early in order to prepare the institutions concerned for the prospectus approval procedures. As a result, it managed to gain an initial impression of the anticipated quantity of prospectuses.

For regular issuers, BaFin published FAQs and templates for approval and notification applications. It also staged a workshop at which the institutions' employees were given information about the approval and filing process under prospectus legislation. The Supervisory Authority also answered numerous written and telephone enquiries from the institutions.

### 3.2 Non-securities investment prospectuses

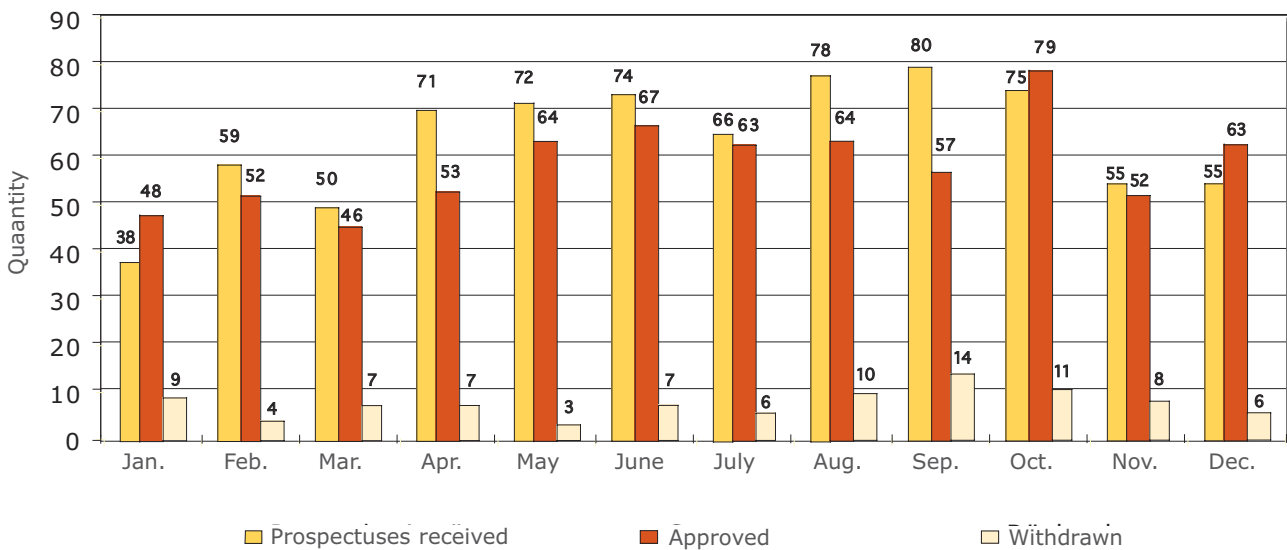
773 prospectuses issued.

In 2008, institutions offering investments submitted a total of 773 sales prospectuses for non-securitised company shares, registered bonds, shares in trust assets and other closed funds to BaFin (2007: 786). For printing purposes, it was not possible to combine several prospectuses in one document.

BaFin authorised publication in the case of 708 prospectuses. It banned two prospectuses because they were incomplete. In 92 cases, the applicants themselves withdrew the application.

Figure 26

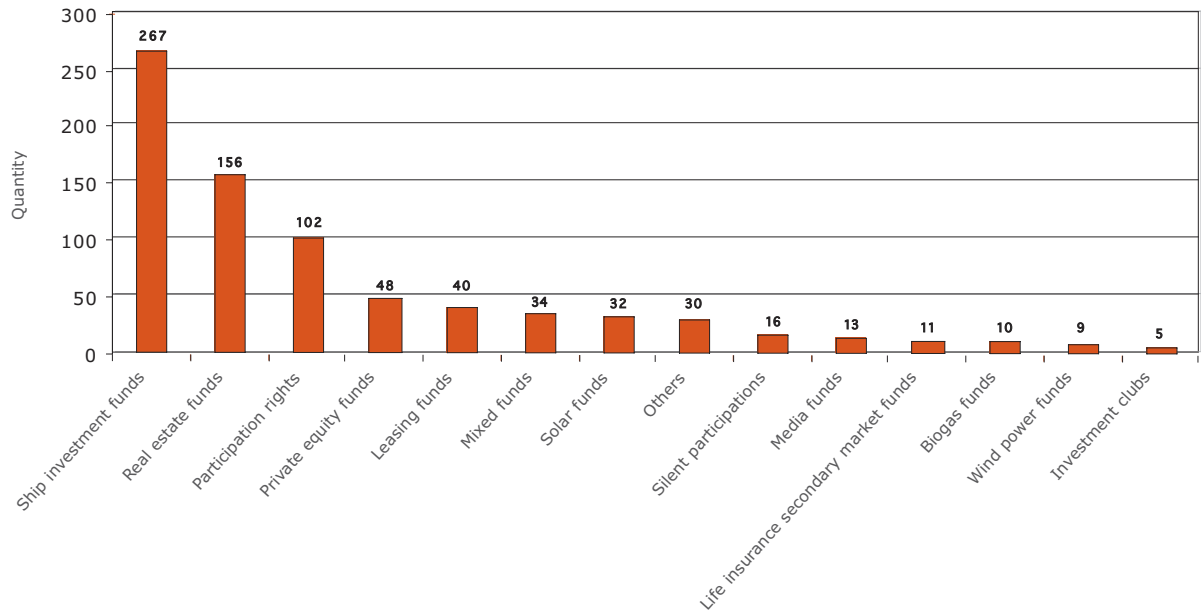
#### Prospectuses received, approved and withdrawn 2008



Ship funds particularly popular.

The providers predominantly took conservative fund models, such as ship funds or real estate funds, to market in 2008. Private equity funds, on the other hand, declined in importance compared with the previous year. The aim of the funds offered was to raise total regulatory capital of €15.7 billion.

Figure 27

**Prospectuses by type of fund in 2008**

Costs for investors are often insufficiently presented.

The prospectuses submitted frequently contained errors in information regarding costs for the investor associated with the purchase, management and sale of non-securities investments. Furthermore, in many cases the providers supplied only inadequate information regarding the deduction of commission for distribution of non-securities investments from the issue capital; failing to provide specific figures for the full amount of commission was one such example. As in previous years, the risks were not adequately described either.

Workshop on issues relating to prospectus legislation.

BaFin discussed current prospectus legislation issues with market participants at its annual workshop. Amongst other things, the discussion addressed the form that supplements to prospectuses must take in the event of material changes. Information was also provided on supervisory licensing requirements for deposit-taking, guarantee and financial brokerage business. The event aims to make those responsible for the prospectuses aware of the respective provisions in order to prevent any breaches from occurring.

Fines proceedings

BaFin opened ten new cases for potential breaches of the Prospectus Act (Verkaufprospektgesetz) (2007: 10). Three cases were still outstanding from the previous year (2007: 1). BaFin imposed one fine of €7,500 and dropped two cases because they were not in the public interest. Ten cases were still pending as at the end of the year.



Setting of charges when combining several sales prospectuses in one document.

### Court rulings

In November 2008, Frankfurt Administrative Court dismissed the action brought by a provider against BaFin's fee decision.<sup>36</sup> In the decision, BaFin calculated charges for approval of a total of eleven sales prospectuses. However, according to the provider, BaFin should only have demanded the fee for one sales prospectus, because it had only submitted one document for approval. Furthermore the prospectus merely described a non-securities investment, because ultimately the investors, as providers of profit participation capital, had a participating interest in only one company. In fact, in the document, the provider described participating interests which differed somewhat in term and level of profit participation. In BaFin's opinion, the document therefore contained eleven sales prospectuses in total, and it can not be a question of these being combined in one document. BaFin therefore authorised the provider's publication of eleven sales prospectuses.

The court states that levying of the fees was based on the legally valid approval decisions and BaFin had rightly charged fees for eleven sales prospectuses. Insofar as the provider opposed BaFin's view that the document submitted constituted sales prospectuses for eleven different non-securities investments, it contested the legitimacy of the approval decisions. These were already legally valid and effective, though, and were therefore not contestable (any longer). The provider had already had an opportunity to contest BaFin's interpretation during the approval process. In the case of a legally valid administrative decision, where the legality of determination of fees for an official act (approval) is concerned, it is only a question of the decisions's effectiveness, not its legality.

The provider filed for admission of an appeal against the judgement, but this application was dismissed by a ruling of 19 March 2009. The judgement which thereupon became legally enforceable bears the nature of a test case. Providers frequently object only to fee decisions; but by that time approval decisions are mostly legally valid.

## 4 Corporate takeovers

Slight fall in number of offer procedures.

As a result of the negative trend on the financial markets and the associated difficulties in financing corporate takeovers, the number of bids was slightly down on the previous year, which had seen a high level of activity. BaFin approved a total of 39 offers in 2008 (2007: 47), 17 in the first six months (2007: 25) and 22 in the second (2007: 22). All the same, the number of offers approved is

<sup>36</sup> Ref.: 1 K 1839/08.F (V).

in line with the average of the last few years. With respect to corporate takeovers, it is the duty of BaFin to ensure that there is sufficient transparency, that bidding procedures are carried out quickly, and that all shareholders are treated equally.

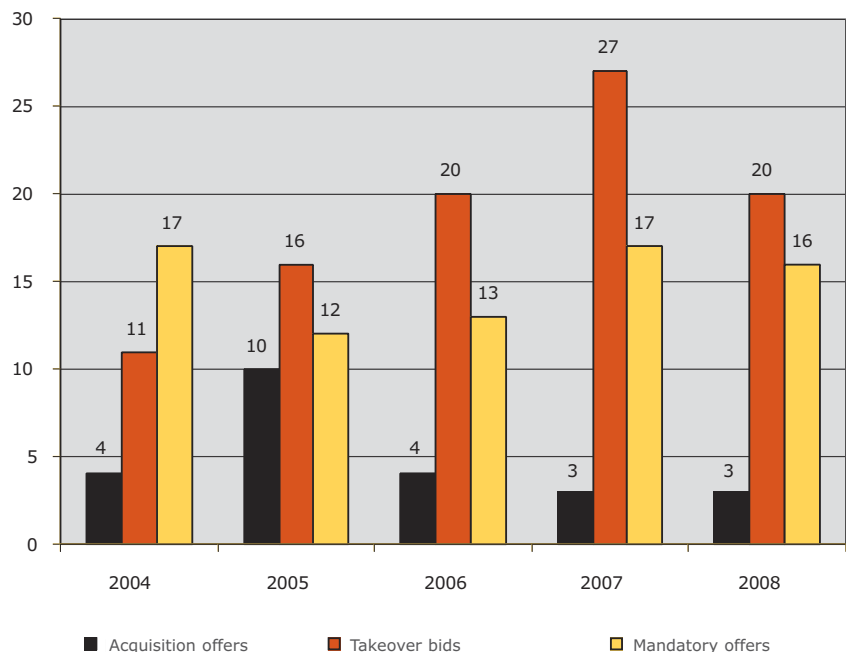
#### 4.1 Offer procedures

BaFin inspected 42 offer documents and approved their publication in 39 cases (2007: 47). Three cases were rejected. A further six offers were rejected on the grounds that the bidders had not complied with the WpÜG and had neither effected publication in accordance with section 10 WpÜG nor submitted an offer document in accordance with section 14 WpÜG. The published offer documents can be downloaded from the BaFin website.<sup>37</sup>

There was a total of 16 mandatory offers (2007: 17), whilst 20 procedures related to takeover bids (2007: 27) and three were straightforward acquisition offers (2007: 3).

Figure 28

##### Number of offer procedures



Fewer voluntary offers.

Transaction volumes.

In 2008, as in previous years, the transaction volume<sup>38</sup> for around half the offers was below €100 million. In the case of twelve offers, the transaction volume was between €100 million and €1 billion; a further three exceeded €1 billion. At approximately €11.8 billion,

<sup>37</sup> www.bafin.de » Databases & lists » Published offers pursuant to section 14 WpÜG.

<sup>38</sup> The transaction volume is calculated by multiplying the number of shares to be acquired by the bidder by the price per share offered as part of the offer procedure. The ancillary transaction costs are then added to this amount.

the takeover bid made by Schaeffler KG to the shareholders of Continental AG was the largest procedure in the year under review in terms of transaction volume, followed by the takeover bid made by TDK Germany GmbH to the shareholders of EPCOS AG (approx. €1.3 billion) and the acquisition offer made by HRE Investment Holdings L.P. to the shareholders of Hypo Real Estate Holding AG (approx. €1.1 billion). The mandatory offer made by QUANMAX Malaysia Sdn Bhd to the shareholders of Gericom AG represented the lowest transaction volume, at approx. €3.5 million.

21 administrative fine proceedings initiated.

In 2008, BaFin initiated a total of 21 new proceedings relating to administrative fines for possible violations of the WpÜG (2007: 20). 25 cases were still pending from previous years. BaFin dropped three cases, two because they were not in the public interest. At the end of the year, 43 procedures were still outstanding.

### **Takeover bid from Schaeffler KG to the shareholders of Continental AG**

In the year under review, attention focused on the takeover bid made by Schaeffler KG (Schaeffler) to the shareholders of Continental AG (Continental) and, in particular, on the question of whether Schaeffler had illegally stalked Continental. The case met with considerable public interest, both at home and abroad.

Bidder gets into position.

On 15 July 2008, Schaeffler made public its decision – the intent to submit a voluntary public takeover bid to the shareholders of Continental. Schaeffler also announced that INA-Holding Schaeffler KG, which has an interest in Schaeffler, held 2.97% of Continental's shares and was entitled to purchase a further 4.95% of Continental's shares. Schaeffler had furthermore concluded swap transactions for some 28% of Continental's shares, which were to be settled in cash and were not, therefore, subject to notification according to section 21 ff. WpHG. Schaeffler could call in these swaps at any time; whether and when they would be called in had not yet been decided. Should Schaeffler decide to call them in, it could be offered up to 28% of Continental shares as part of the offer procedure.

BaFin investigates swap transaction.

Back in March 2008, Schaeffler had concluded a total return equity swap with Merrill Lynch International (Merrill Lynch) for Continental shares. This was a contract for difference, in which two contracting parties bet on rising or falling prices. The contract is not geared to actual delivery of shares, but is to be settled by a cash payment.

By the end of May, Schaeffler had built up a swap position for approx. 28% in total of Continental's voting capital as part of the swap transaction. There was disagreement as to whether the Schaeffler Group thus had access to around 36% of the share capital. A further question arose as to whether Schaeffler had violated the WpÜG and WpHG in building up this position and whether BaFin should have prohibited the announced voluntary takeover bid or the settlement of the agreed swaps.

BaFin therefore examined whether Schaeffler had to have voting rights attributed to itself from shares held by Merrill Lynch or third parties in connection with the swap agreement, and whether Schaeffler would therefore have been obliged to make a mandatory offer at an earlier stage. In addition, BaFin had to clarify whether Schaeffler should not have issued a voting rights notification because of holding other financial instruments (section 25 WpHG) due to the swap position.

### Transparency requirements

Control equates to holding 30% of voting rights in a target company (section 29 (2) WpÜG). According to section 30 WpÜG, the bidder's voting rights also include i.a. such voting rights as belong to third parties and held by them for the account of the bidder (section 30 (1) sentence 1 no. 2 WpÜG). The same applies to voting rights from shares that the bidder can acquire by means of a declaration of intent (section 30 (1) sentence 1 no. 5 WpÜG). Furthermore, reciprocal attribution to the bidder and to participating third parties then takes place in the event of a bidder coordinating his actions with third parties in more than just one case where the target company is concerned (section 30 (2) WpÜG).

The voting right holder must immediately inform the securities issuer and BaFin, within four trading days at the latest, if a relevant threshold is reached, exceeded or not met (section 21 ff. WpHG). In addition, notification obligations are to be observed when other financial instruments are held (section 25 WpHG). They apply to those who directly or indirectly hold financial instruments that grant them the right, as part of a legally binding agreement, to unilaterally purchase at least 5% of the voting rights with respect to the issued shares with associated voting rights in a target company.

In turn, the issuer must immediately publish a notification pursuant to section 21 ff. WpHG or section 25 WpHG, at the latest three trading days after receipt thereof (section 26 WpHG).

● No violation of WpÜG or WpHG found.

When examining the Schaeffler case, the latter's own securities transactions and the swap agreement concluded in March 2008 between the bidder and Merrill Lynch, BaFin was unable to establish any violation of the securities legislation provisions.

● No entitlement to the delivery of shares.

BaFin found that, when concluding their swap transaction, Schaeffler and Merrill Lynch had agreed that it would be terminated with a cash settlement. However, Schaeffler was neither entitled to the delivery of those shares with which Merrill Lynch had provided cover for itself – at least temporarily – to hedge its own risks, nor was Merrill Lynch obliged to accept any potential takeover bid submitted by Schaeffler.

● No attribution of voting rights...

Likewise, there were no grounds for the attribution of voting rights in light of the contractual nature of the swap agreement, even taking into account purely factual considerations.

● ...neither in accordance with section 30 (1) sentence 1 no. 2 WpÜG...

In particular, it could not be confirmed that Merrill Lynch was holding Continental shares for the account of Schaeffler. Had Schaeffler potentially derived gains or borne the risks from these Continental shares, this would have constituted an important indicator for this. However, BaFin found that this was not the case. Rather, the sole aim of both contracting parties in concluding the swap transaction was to make gains in the event of a change in the stock exchange price of the Continental shares. There were few if any indications of a shift in the inventory risk of the shares or in the risk of receiving compensatory payments or indemnities, and the same goes for the reference risk, for instance. Moreover, the swap agreement between Schaeffler and Merrill Lynch contained no rule that would have permitted Schaeffler – at least in theory – to influence voting rights acquired by Merrill Lynch from Continental shares. In particular, it was unclear why and to what extent Merrill Lynch should feel obliged to exercise its voting rights in the interests of the bidder. In fact, Merrill Lynch was able to (continue to) hold the shares contributing to its own risk hedging without restrictions.

● ...nor in accordance with section 30 (1) sentence 1 no. 5 WpÜG...

BaFin also failed to detect any agreements according to which Schaeffler would have been in a position to acquire Continental shares by means of a declaration of intent. This attribution rule only covers structures in which the bidder can acquire shares in rem without the cooperation of the vendor or of a third party by means of a unilateral declaration of intent; this is particularly the case with call options in rem. The holder of an option in rem is thus a person who is entitled to acquire ownership of shares based on the acceptance of the earlier, irrevocably made transfer offer. The contractual agreements between Schaeffler and Merrill Lynch, however, did not provide for any physical delivery of shares in the target company. According to the findings of BaFin, corresponding accessory agreements were likewise not concluded.

● ...nor in accordance with section 30 (2) WpÜG.

There was just as little evidence for an acting in concert.<sup>39</sup> No evidence of corresponding agreements was found. In particular, there had been no content-related agreements on the exercising of voting rights at the annual general meeting of the target company, which would have been necessary as per the applicable court ruling by the Federal Court of Justice (Bundesgerichtshof – BGH).<sup>40</sup> In addition, it was in any case likely that there was no overall corporate plan given the absence of any evidence with respect to Merrill Lynch having an interest in the corporate management of the target company. There was not even any evidence, as has been alleged in some quarters, of an agreement between the contracting parties to the effect that Merrill Lynch was in support of the impending takeover bid from the bidder.

<sup>39</sup> This estimate is based on section 30 (2) of the old version of the WpÜG (in the version prior to the enactment of the Risk Limitation Act on 19 August 2008).

<sup>40</sup> Ref.: II ZR 137/05, BGHZ 169, p. 98 ff.

● No violation of voting rights obligations.

BaFin was also unable to detect any violation on the part of Schaeffler of the notification obligation due to the holding of other financial instruments (section 25 (1) WpHG). In accordance with section 25 WpHG, the notification obligations only cover such financial instruments as entitle their holder to acquire, unilaterally and under a legally binding agreement, shares in a target company that carry voting rights and that have already been issued. Here, the key issue is that the holder of the financial instrument can actually acquire the shares. In contrast, the cash settled equity swaps relevant to the relationship between Schaeffler and Merrill Lynch are beyond the scope of application of section 25 WpHG, as they do not grant the right to acquire the shares.

● Inspection of the offer document.

Schaeffler had submitted the corresponding offer document to BaFin just a few days after the publication of the decision on the submission of a takeover bid. As no clear violation could be detected within the ten-day inspection period – even taking into consideration investigation results already available at this stage – BaFin approved the publication of the offer document on 29 July 2008. The supervisory authority may only reject an offer if information in the offer document is in clear breach of WpÜG provisions or of an ordinance adopted under this Act. Schaeffler then published the offer document on 30 July 2008.

● Schaeffler completes takeover in January 2009.

BaFin completed its investigations on 20 August 2008. During the night from 20 to 21 August 2008, Continental announced that Schaeffler and Continental had settled their dispute. Schaeffler agreed to increase the price offered to €75 per share. In return, Continental dropped its resistance to the takeover bid.

On 19 December 2008, the European Commission also approved the takeover, stating that there was no danger of it significantly impeding effective competition. Schaeffler then completed the takeover in January 2009 and paid the agreed price to the shareholders who had accepted the offer.

### Cross-border cases

As in previous years, the proportion of cross-border offer procedures, totalling 24 cases (2006: 24, 2007: 26), was high. These are cases in which the bidder or its parent undertaking is domiciled outside Germany. Offers from the United Kingdom, Austria, Luxembourg, the Netherlands, the USA and Switzerland were the main focus.

● Division of supervisory duties for two cases.

In two cases, a further supervisory authority in addition to BaFin was responsible for investigating a takeover bid. The first of these was the mandatory offer made by Cross Industries AG, Wels (Austria), to the shareholders of BEKO Holding AG, Nöhagen (Austria), and the second was the mandatory offer made by QUANMAX Sdn Bhd, Penang (Malaysia), to the shareholders of Gericom AG, Linz (Austria). As the shares in the target companies were exclusively listed for trading on a regulated market in Germany, BaFin investigated all matters connected with the share

price offered, the content of the offer document and the offer procedure. The Austrian Takeover Commission, for its part, dealt with the issue of the acquisition of a controlling interest within the meaning of the Austrian Takeover Act and named the parties with an obligation to make an offer in corresponding official declarations. The reason for this division of supervisory duties lies in the Takeover Directive.

### Court rulings

Presumption of appropriateness for squeeze-outs refutable.

If, following a takeover bid or mandatory offer, a bidder holds shares in the target company amounting to at least 95% of the voting share capital, he may request that the remaining voting capital be transferred to him by means of a court ruling and in exchange for an appropriate compensatory payment (section 39a (1) WpÜG). In the case of such a squeeze-out under takeover law, the presumption exists that the share price granted within the framework of a takeover bid or mandatory offer is to be regarded as an appropriate compensatory payment, provided that the bidder has acquired shares amounting to at least 90% of the voting share capital of the target company based on the offer (section 39a (3) sentence 3 WpÜG).

In August 2008, the Frankfurt Regional Court (Landgericht – LG) ruled that this presumption can be refuted.<sup>41</sup> Shares acquired by the bidder during the acceptance period based on previous agreements in which the shareholders committed themselves irrevocably to accept the offer (so-called irrevocable undertakings) may also be taken into consideration when determining whether the bidder has acquired at least 90% of the share capital relevant to the offer on the basis of the offer. However, the bidder may not request the transfer of the shares based on a court decision if the minority shareholders put forward concrete circumstances which cast doubt on the presumption made in section 39a (3) sentence 3 WpÜG. In this case, the appropriateness of the share price could not be determined.


In December, however, the Frankfurt Higher Regional Court (Oberlandesgericht – OLG) ruled on the appeal lodged against this, deciding that the remaining shares had to be transferred to the bidder in exchange for a compensatory payment amounting to the share price granted within the framework of the preceding takeover bid.<sup>42</sup> The Court of Appeal did not comment on whether it had been a matter of an irrefutable presumption, a fiction or a refutable presumption when ruling on the issue of appropriateness, due to a lack of relevance. At any rate, purely approximate assessments on the basis of previous company valuations or annual reports could not refute the legal presumption. It would have been necessary to find concrete errors which had influenced the outcome. The legislator had structured the squeeze-out under takeover law in such a way as to produce a quick and relatively uncomplicated process, not least to avoid the legal proceedings

<sup>41</sup> Ref.: 3-05 O 15/08, BB 2008, p. 2035 ff.

<sup>42</sup> Ref.: 20 W WpÜG 2/08.

initiated by shareholders under stock corporation law, which can be excessively lengthy. The legislator assumes, as he is entitled to do, that findings from the capital markets relating to pre-acquisitions and market prices can be applied. Based on these considerations, it could be assumed that the attainment of the success threshold of 90% reflects the market forces and that this very high level of success in an offer could not be reached if the full compensatory payment for the shares acquired in the company were not offered to the market. For this reason, there was no need in principle to fall back on microeconomic valuation methods for calculating compensation. The ruling of the Frankfurt Higher Regional Court is *res judicata*.

## 4.2 Rejections

 BaFin rejects nine takeover bids.

In 2008 BaFin rejected nine offers relating to seven companies. These were offers made to shareholders of Bayer Schering Pharma AG, Creaton AG, Eurohypo AG, IM Internationalmedia AG, GfK AG, Petrotec AG and Travel24.com AG. BaFin has to reject takeover bids if bidders do not comply with the specifications of the WpÜG.

A number of the rejected takeover bids are described below.

In a takeover bid by Taylor Nelson Sofres plc, London (TNS), announced on 3 June 2008, the bidder proposed a share swap to the shareholders of GfK AG. However, after the WPP Group plc, London, had submitted a better offer for TNS, the latter refrained from making a decision on the submission of a takeover bid. BaFin therefore rejected the takeover bid on 10 July 2008 on the grounds that an offer document had not been submitted.

BaFin rejected the takeover bid made by IC Green Energy Ltd., Tel Aviv, to the shareholders of Petrotec AG, as the bidder – even by the extended deadline of 15 working days – had not been prepared to name in the offer document all the persons acting jointly with it. Finally, BaFin rejected the takeover bid made by MAXX International Inc. (MAXX) to the shareholders of Travel24.com AG. MAXX had published an exchange offer for its treasury stock on the Internet. The online publication represented an offer document which had not been verified by BaFin and which was in clear breach of the WpÜG. For instance, the offer was a prohibited partial offer and mandatory information as stipulated by law was missing from the publication. The rejection rendered all agreements resulting from the offer null and void.

Following the rejection, MAXX attempted to broker the exchange of shares in Travel24.com AG via the Best Investment Company Inc. (Best). To this end, the company used the contact details of the Travel24.com AG shareholders who had made themselves known to MAXX on the basis of the rejected offer. BaFin intervened once again and denied both Best and the custodian bank any form of disposition regarding the shares in Travel24.com AG. At the same time, BaFin prohibited Best from concluding contracts aimed at the transfer of shares in Travel24.com AG.



### 4.3 Exemption procedures

● Number of applications for exemption back to normal.

BaFin received 94 applications for exemption. In 37 cases, holders of voting rights applied for the voting rights not to be taken into account in accordance with section 36 WpÜG; 57 applications were for exemption in accordance with section 37 WpÜG. This represents a considerable decline in comparison with the previous year (230). This is due to the fact that the original legal situation regarding the attribution of voting rights has been restored. In 2006 and 2007, the number of applications for exemption had risen sharply due to the group-wide attribution of the voting rights of a subsidiary as a result of the implementation of the Takeover Directive.<sup>43</sup>

BaFin approved 37 applications and rejected one. 13 applications were withdrawn by the applicants, and 43 applications were still being processed at the end of the year under review.

● Focus still on restructuring within groups of companies and exemptions on the grounds of a company rescue.

Once again, virtually all applications in accordance with section 36 WpÜG concerned the acquisition of a controlling interest in the wake of restructuring within the group of companies. Just three applications related the devolution of an estate or a gift and one application to a change of legal form. As in previous years, applications in accordance with section 37 WpÜG were predominantly submitted with a view to the rescue of a target company.

A number of the exemption procedures are described below.

#### **IKB Deutsche Industriebank AG**

The exemption approved by BaFin for the rescue of IKB Deutsche Industriebank AG (IKB) had major significance for the financial market. The crisis on the US mortgage market had put IKB in considerable difficulty. The major shareholder in IKB with some 45% was the state-owned Reconstruction Loan Company (Kreditanstalt für Wiederaufbau – KfW), which had taken initial support measures back in 2007. A capital increase guaranteed by KfW was carried out in the second half of 2008 to provide further support for IKB. After this capital increase had been brought to a conclusion in October 2008, KfW's participation in IKB exceeded 90%. As early as mid-2008, a bidding procedure had been carried out with respect to KfW's participation in IKB after the capital increase, the award going to the Lone Star Group.

With the transfer of the IKB share block from KfW to Lone Star at the end of October 2008, Lone Star gained a controlling interest in IKB within the meaning of the WpÜG. For this reason, Lone Star had already submitted an application for an exemption from making a mandatory offer (exemption on the grounds of a company rescue) before acquiring a controlling interest. BaFin granted this application on 22 October 2008.

<sup>43</sup> 2006 Annual Report, p. 185, and 2007 Annual Report, p. 195.

- Limited capacity to provide refinancing threatens companies' survival.

Risks jeopardising the survival of IKB were detected in the form of impending liquidity problems caused by its limited refinancing capacity, which justified the approval of the application on the grounds of a company rescue. Alongside an increase in regulatory capital by means of the capital increase guaranteed and carried out by KfW, further measures were also necessary for the rescue of IKB, such as introducing liable own funds under banking supervision law or hiving off particular securities portfolios. On balance, these were the right measures designed to stabilise the liquidity situation of IKB to a marked extent, thus averting the risks threatening the bank's survival.

- Capital increase not a rescue contribution.

In addition, incidental provisions obliged Lone Star to pay the required rescue contributions amounting to €360 million in accordance with the rescue plan submitted. The capital increase amounting to €1.25 billion did not constitute a rescue contribution, as this had been provided by KfW and was not closely linked to the acquisition of IKB by Lone Star from an economic point of view. The condition for this would have been a mathematical relationship between the expenditure for the capital increase and the purchase price obtained for the stake in IKB – essentially consisting of the new shares from the capital increase – which relationship prompts a player mindful of commercial considerations to effect the capital increase, in an easily comprehensible way. This could not be detected in the case at hand, as the capital increase by KfW was not made with the intention of paying a rescue contribution on behalf of Lone Star, but had been done to serve the higher national interest.

### Evotec AG

In May 2008, BaFin exempted JP Morgan Chase Bank, New York (JP Morgan Chase) from submitting a mandatory offer. After a capital increase at the beginning of May 2008, its share of voting rights in Evotec AG had risen beyond the control threshold to 32.18%. The capital increase had been carried out because JP Morgan Chase wanted to take over Renovis Inc., USA (Renovis), via a share swap, for which it offered the Renovis shareholders Evotec shares in the form of so-called American depositary shares (ADS) – certificated by American depositary receipts (ADR). The new Evotec AG shares from the capital increase formed the basis of the ADR. Furthermore, the bank had committed itself through agreements with the ADR holders to hold the new Evotec AG shares on their behalf. The agreement stipulated that the applicant had to pass on paid dividends and other distributions to the ADR holders and was only permitted to exercise voting rights for the shares held on behalf of the ADR holders in accordance with their instructions. In the eyes of the law, however, the applicant was the owner of the new shares.<sup>44</sup>

<sup>44</sup> The applicant, however, was not obliged to provide notification for the resultant voting rights. Section 21 (1) sentence 2 WpHG only assigns notification duties on the holder of certificates in respect of depositary receipts.

● Exemption possible despite formal ownership in the case of ADS.

The exemption was justified based on the objective which the acquisition of a controlling interest was intended to serve (section 37 (1) alternative 2 WpÜG). The takeover of Renovis via a share swap using ADS and ADR was intended to simplify the cross-border company acquisition and to permit the trading of shares listed on a foreign stock exchange. In this process, the applicant was only permitted to perform its role as a transaction and settlement bank within the limits stipulated in the agreements with the ADR holders. The planned divergence with respect to the legal ownership of the shares regarding the applicant on the one hand and their economic ownership regarding the ADR holders on the other resulted from the fact that, due to legal differences between US and German corporate law, it is not possible to regard US investors as shareholders in the true sense. For this reason, as a result of issuing ADR for the underlying shares in the target company, held by the applicant, and of the agreements, it was intended to put the ADR holders in a position which was as close to the legal ownership of shares as possible. The function of the bank was restricted to performing the increase in real capital in the course of the acquisition of Renovis by the target company and to the aforementioned activity for the ADR holders; it was barred by the terms of its agreement from influencing the corporate governance of the target company on the part of the applicant.

● Donation can justify exemption from mandatory offer.

#### **Ferdinand Karl Alpha Privatstiftung, Vienna**

In March 2008, the Ferdinand Karl Alpha Privatstiftung (private foundation), Vienna, applied for an exemption from the obligation to make a mandatory offer to the shareholders of Porsche Automobil Holding SE (Porsche) and Volkswagen AG (Volkswagen). The applications were submitted because Prof. Dr. h.c. Ferdinand Karl Piëch wished to transfer his stake in Piëch GmbH, Salzburg, at the end of July 2008 in the form of a gift to the Ferdinand Karl Alpha Privatstiftung. Therefore, the following indirect transfers to the Ferdinand Karl Alpha Privatstiftung were made: 100% of Ferdinand Piëch GmbH, Grünwald, a subsidiary of Piëch GmbH, Salzburg; 6.58% of ordinary shares in Porsche, and 6.58% of the shares held by Porsche in Volkswagen. As a result, the foundation acquired indirect control of Porsche and Volkswagen by means of a voting trust agreement between Ferdinand Piëch GmbH, Grünwald, and other participating companies.

BaFin approved the exemptions for the Ferdinand Karl Alpha Privatstiftung in May 2008 on the grounds of a gift (section 37 (2) WpÜG in conjunction with section 9 sentence 1 no. 2 of the Ordinance on Offers under the WpÜG (WpÜG-AngebotsV). The gift to the applicant was to be considered as one between parties which are not related within the meaning of section 36 no. 1 WpÜG. This means that the facts on which the exemption of the gift is based apply even if there is no kinship at all between donor and bidder, or – as in this case between Prof. Dr. h.c. Ferdinand Karl Piëch and the foundation as a legal entity – no such relationship can possibly exist. A precondition for this is, however, that the continued management – not just in the short term – of what are essentially family firms, irrespective of their size or

significance, is planned, for example by siblings, employees of outstanding merit or, as is the case here, by legal entities close to or attached to the family. As the stake had been transferred in order to maintain the continuous running of the Porsche and Volkswagen companies, shaped by the Piëch family – alongside the main Porsche dynasty – the interest of the Ferdinand Karl Alpha Privatstiftung in an exemption also outweighed the interests of the other shareholders in the target company in making a mandatory offer.

## 5 Financial reporting enforcement

### 5.1 Monitoring of corporate financial statements

1,037 undertakings subject to financial reporting enforcement.

In the year under review, a slight fall was recorded in the number of undertakings subject to financial reporting enforcement. As at 1 July 2008, a total of 1,037 undertakings from 21 countries were subject to financial reporting enforcement (2007: 1,075 undertakings from 22 countries). The 1,037 undertakings comprise 863 German undertakings, a further 128 European undertakings (89 from EU Member States) and 46 undertakings from six non-European states. The following table shows the distribution by country.

Table 25  
**Enforcement by country**  
As at 01.07.2008

Germany	863
The Netherlands	32
USA	26
Jersey	23
Austria	18
United Kingdom	12
Switzerland	12
Japan	9
France	8
Israel	7
Luxembourg	6
Republic of Ireland	5
Italy	3
Spain	3
Finland	2
Guernsey	2
Canada	2
Australia	1
Cayman Islands	1
Iceland	1
Norway	1
<b>Total</b>	<b>1,037</b>

Financial reporting enforcement is a two-tiered process. The German Financial Reporting Enforcement Panel (FREP) and BaFin undertake an audit of the consolidated financial statements of companies whose securities are admitted for trading on a regulated market. Based on this process, the accounting principles to be investigated range from the German Commercial Code through the IFRS and US-GAAP to individual national provisions.

In 2008, BaFin collaborated with the supervisory authorities from France, the United Kingdom, Ireland, Israel, Japan, Jersey, Luxembourg, the Netherlands, Austria, Switzerland, Spain and the USA. With regard to the auditing of foreign undertakings whose securities are admitted in Germany, BaFin first establishes whether potential violations are already being audited by the relevant enforcement authority in their home country. The undertakings are thus spared repeat audits and the efficiency of the audit is increased.

In the year under review, FREP completed 138 audits, of which 118 were audits based on random sampling, 19 were indication-based audits and one was an audit requested by BaFin.<sup>45</sup>

<sup>45</sup> Source: FREP.

BaFin completed a total of 33 procedures in 2008 (2007: 33). In 28 cases, the undertakings concerned had stated their agreement with the result of the FREP audit; in 27 of these cases, BaFin ordered the publication of errors. In one case, BaFin refrained from ordering the publication of errors. BaFin is able to proceed in this way if the information is not in the public interest or if publication of the error is likely to harm the legitimate interests of the undertaking. Of the five cases in which the undertaking did not accept FREP's findings, BaFin concluded four cases with an identification of errors and ordered the publication of errors in three cases. In one case, it was possible to forgo the publication of errors. However, one error identification procedure ended without any complaints.

● Frequent errors in allocation of purchase price for company takeovers.

As in previous years, errors occurred with particular frequency when describing the acquisition and sale of companies, most notably with regard to the allocation of the purchase price. Problems also arose in terms of the information reported, e.g. annual or risk reports, reports on associated undertakings or persons, and segment reports.

Below is a summary of the results of the error identification and error publication procedures completed since enforcement began in 2005.

Table 26  
**The BaFin enforcement procedure (July 2005 to December 2008)**

	Error(s) detected:	Error(s) detected:	Error(s) published:	Error(s) published:
	yes	no	yes	no
1) Undertaking accepts error(s) detected by FREP	61		59	2
2) Undertaking does not accept error(s) detected by FREP	9	2	7	2
3) Undertaking refuses to cooperate with FREP	0	0	0	0
4) BaFin has considerable doubts as to the accuracy of the investigation result or the FREP procedure	1	0	0	1
5) Takeover of inspection (banks and insurers)	0	0	0	0
<b>Total</b>	<b>71</b>	<b>2</b>	<b>66</b>	<b>5</b>

With respect to the error identification procedures, BaFin has mostly been involved in cases in which the undertakings did not accept the errors identified by FREP (9; case group 2). Although BaFin came to a similar conclusion in the majority of these cases, i.e. that the undertaking's accounts contained errors, there were discrepancies in some instances in respect of the number and type of errors detected.

In 66 cases in which an error was detected, BaFin also ordered its publication. It refrained from ordering the publication of errors in five cases because a legitimate company interest outweighed the public interest.

● Three undertakings threatened with fines.

In the year under review, BaFin threatened to fine three undertakings after they had initially failed to comply with the publication order. In all three cases, the errors were subsequently published.

### Court rulings

In January 2009, the Frankfurt Higher Regional Court ruled that the identification of errors and an order for their publication are legally valid if the accounts audited violate statutory provisions, including the principles of proper accounting, or are in breach of other accounting standards permitted by law, and if the violation(s), either individually or collectively, are substantial from the point of view of the capital market.<sup>46</sup> The Higher Regional Court rejected the complaint of one undertaking against the identification of errors and against the publication order issued by BaFin. The undertaking had complained that BaFin should not have been permitted to identify the errors found because they represented negligible violations of accounting regulations. Nor was it in the public interest, it claimed, to publish such violations. In addition, due to negative effects, publication conflicted with the undertaking's legitimate interests.

The Higher Regional Court stressed that the publication of errors constituted the most important measure in the enforcement process. It was in line with the basic concept of the law that priority should be given, as a matter of course, to the capital market's interest in information over the interest of the undertaking being audited in keeping its accounting errors confidential. The legislator deliberately wished to use the negative impact the publication of errors would have to achieve the objectives of the enforcement process. Only atypical circumstances could be considered as legitimate company interests which would militate against publication. Thus an undertaking must accept in particular the fact that its share price may suffer as a result of the publication of errors – this equally applied when taking into account price losses caused by the financial crisis. Furthermore, the avoidance of possible damage to an undertaking's reputation does not count as a legitimate company interest. Market participants and other participating parties were credited with the ability of appropriately classifying the type and extent of the accounting errors so that the fear of loans becoming dearer or the issue of treasury stock becoming more difficult would have to be discounted as a valid argument.

## 5.2 Publication of financial reports

Financial reports to be compiled in accordance with sections 37v ff. WpHG should enable investors to make a sound assessment of an issuer's situation by means of a regular flow of reliable information. Capital-market-oriented undertakings are thus obliged by law to

<sup>46</sup> Ref.: WpÜG 1/08 and 3/08.

compile annual and half-yearly financial reports as well as interim management reports and to make them available i.a. in the Company Register. An essential component of annual and half-yearly financial reports is the declaration of conformity, often referred to as the "Bilanzzeit", or "sworn balance sheet" (sections 264 and 289 HGB).

● Issuers' obligations.

In accordance with sections 37v ff. WpHG, issuers must, in principle, make available their entire accounting documentation or the complete interim management reports on the Internet and publish an announcement by forwarding it to the media for dissemination across Europe. It must be made clear in the announcement from what date and where on the Internet the entire accounting documentation or the complete interim management reports are available. BaFin must be informed of the publication of the announcement. Furthermore, the announcement and the accounting documentation/interim reports must be forwarded to the Company Register. The Company Register is the officially designated central data storage system.

● Publication system still causing problems.

BaFin adopts a risk-oriented approach to its monitoring of undertakings' compliance with financial reporting obligations and expanded the scope of its examinations considerably in the second half of 2008. In this regard, it became clear that many issuers are still unfamiliar with the publication system introduced in 2007, i.e. actively forwarding announcements to the relevant media for dissemination across Europe and communicating them to the Company Register.

In future, therefore, BaFin will continue to target undertakings which do not meet their obligations and will enforce compliance with such obligations. It will also maintain its existing dialogue with practitioners.

● BaFin publishes information on financial reporting.

In 2008, too, BaFin responded to numerous queries regarding financial reporting obligations from undertakings, legal practitioners and service providers. The most frequently asked questions and corresponding answers were compiled in the form of a list and published on the Internet.<sup>47</sup> It contains information such as advice from BaFin on how the "sworn balance sheet" is to be formulated, what information financial reports must contain and how they are to be made available to the public.

#### **Publication of financial reports by issuers in non-Member States**

If an undertaking from a non-Member State applies to BaFin for an exemption from the publication scheme for financial reports in accordance with sections 37v ff. WpHG, the supervisory authority can release the undertaking from its obligations (section 37z (4)

<sup>47</sup> www.bafin.de » English Version » Companies » Listed companies » Financial reporting.

WpHG). The applicant must, however, be subject to the equivalent regulations of a non-Member State or must submit to such regulations but the exemption only applies to the content of the reports. If BaFin grants an exemption, this does not mean that the undertaking has no financial reporting obligations at all. In fact, it must make available the information required by the regulations of the non-Member State in the manner stipulated in the WpHG both to the public and to the Company Register for storage purposes. It is also obliged to publish an announcement, to inform BaFin of its publication and to forward the announcement to the Company Register.

BaFin exempted from the requirements of sections 37v ff. WpHG a Swiss undertaking whose shares are listed i.a. on the Swiss Stock Exchange in the so-called EU-compatible segment. It also confirmed the equivalence of US annual financial reporting regulations to be applied to issuers domiciled outside the USA.

## 6 Supervision of investment business

The German funds sector, too, was hit by the global financial crisis in 2008. Both the drying up of the secondary market for pension and money market instruments and the loss of confidence in the integrity of the financial system amongst investors led to the redemption of a large number of share certificates and thus caused liquidity bottlenecks for several German funds. According to asset management company estimates, the federal government guarantee for bank deposits was a factor contributing to the massive net cash outflows.

### 6.1 Asset management companies

As at the end of 2008, 76 German asset management companies were authorised to manage investment funds in accordance with the InvG (2007: 78). 24 asset management companies applied to have the scope of their authorisation extended in the year under review. In 2008, 24 asset management companies applied for authorisation to manage the new categories of funds (infrastructural separate assets, other separate assets) introduced by the Act Amending the German Investment Act (Investmentänderungsgesetz – InvÄndG) at the end of 2007.

As at the end of the year under review, the asset management companies were managing a total of 6,031 separate assets funds (2007: 5,995) with assets totalling €907 billion (2007: €1,042 billion). Of these, 2,043 were retail funds (2007: 1,746) with assets of €273.5 billion (2007: €353 billion) and 3,988 were

2,043 retail funds and 3,988 special assets funds.



speciality funds (2007: 4,249) with assets of €633.5 billion (2007: €689 billion). 46 retail funds were merged or transferred; 32 were dissolved. The number of open-ended public investment companies rose from eight to twelve.

Financial crisis affects new approvals.

The number of newly approved retail funds was down to 278 (2007: 377). The fall was particularly marked in the second half-year. It was caused by the financial crisis and its impact on the performance of the separate assets funds. Demand for new products was therefore confined to separate assets funds designed to preserve value; in essence, funds structured in this way rely on the stability of government bonds with the highest credit rating and on fixed-term deposits, or alternatively provide for performance guarantees.

No applications for advance approval.

No company made use of the option, introduced at the end of 2007, of applying for advance approval for separate assets funds (section 43a InvG). This is due to the speed at which BaFin grants approvals, which compares favourably with the rest of Europe, and the availability of up-to-date sample contractual conditions approved by the Federal Investment and Asset Management Association (Bundesverband Investment und Asset Management e.V. - BVI), which tend to be used as the basis for actual contractual conditions. In the case of an advance approval, BaFin does not approve the actual contractual conditions for the establishment of a separate assets fund but simply the sample clauses. BaFin then only needs to be notified by the company of the establishment of the new separate assets fund.

Planning and controlling the intensity of supervision.

### Risk-oriented supervision

Following completion of preliminary work, BaFin implemented its risk classification procedure for asset management companies at the beginning of 2009. This makes it possible to obtain an overall view of the risk structures of asset management companies and to plan and control the intensity of supervision for individual companies in a risk-oriented manner. Risk-relevant information relating to solvency and market supervision, such as audit results, type of business, business volume, reports and complaints, form the basis for this individual treatment of asset management companies.

Risks are classified based on set criteria and awarded a score. Three sub-categories exist: Asset, financial and income situation (sub-category 1), quality of management (sub-category 2) and quality of organisation (sub-category 3). The scope of impact of the risks is graded according to predefined thresholds. The overall classification is determined based on the assessment of quality and the scope of impact score. The resulting rating is shown in a twelve-field matrix.

Table 27

**Results of 2008/2009 risk classification**

Investment companies		Quality				Total
		A	B	C	D	
Impact	High	28	5	0	0	33
	Medium	21	2	0	0	23
	Low	16	2	0	0	18
Total		65	9	0	0	74*

\* One company was not included as it had not been in business for long enough; another company relinquished its authorisation at the end of 2008 with effect from 2009.

● Three special audits carried out.

In 2008, special audits were carried out at three asset management companies managing real estate separate assets funds, focusing on "Organisation" and paying particular attention to outsourced areas. The auditors found no serious shortcomings at the companies audited. With regard to minor shortcomings, the companies were requested to respond in writing with their comments.

## 6.2 Investment funds

In 2008 the focus of supervision was once again on the investigation of financial risks to German separate assets funds. To investigate these risks, BaFin assessed liquidity and market risks as well as issuer and counterparty risks.

● Daily trend reports from asset management companies.

Money market, pension and participation funds had been particularly badly hit in the wake of market turmoil following the closure of well-known investment banks and as a result of the drastic collapse in the prices of numerous financial instruments, and found themselves exposed to an increase in the rate of redemption of share certificates by their holders. As of October 2008, therefore, BaFin requested that German companies submit trend reports on a daily basis for the purposes of monitoring their liquidity risk. In these, the companies reported on the criteria which could lead to a fund being liquidated, e.g. net cash outflows or the raising of credit. Ultimately, one participation fund had to be liquidated in October 2008 because investors' redemption demands could no longer be met due to a shortage of liquid funds and it is currently impossible to sell the participation certificates due to the illiquidity of the market in participation certificates. Three further liquidations followed in March 2009, of which two were participation funds and one was a fund which had primarily been invested in subordinated bonds.

Rise in the number of outliers reported in accordance with the DerivateV.

With regard to its evaluation of reports in accordance with the Derivatives Ordinance (Derivateverordnung – DerivateV), BaFin observed considerably more outliers per year for many separate assets funds in 2008 than had been expected in light of the stipulated probability level of 99%. However, the turbulent market conditions do provide a plausible explanation for this state of affairs. The evaluation of notifications in accordance with the DerivateV provides indications of how the companies are dealing with the market risk of their separate assets funds. The ordinance requires companies to ensure that the risk models for asset management companies show at least a satisfactory degree of accuracy in their forecasts. From a statistical point of view, this is the case if there are between two and four outliers per year for each separate assets fund.

No complaints regarding issuer's or counterparty risk.

In the year under review, BaFin evaluated the audit reports and annual reports of approximately 1,520 retail funds and held supervisory talks on illiquid assets and on the DerivateV, amongst other issues. However, there were no complaints regarding the asset management companies' handling of issuer and counterparty risks.

Main subject of complaints: losses in market value.

In the year under review, BaFin received 93 complaints regarding the investment sector (2007: 55). In particular, holders of shares in a fund were dissatisfied with the performance of the separate assets funds they had acquired. Another common complaint amongst holders concerned the suspended redemption of share certificates in real estate funds.

Funds sector indirectly affected by Madoff scandal.

BaFin understands that, at the time of going to print, the fraud scheme operated by US investor Bernard Madoff had only had a minor and indirect impact on German investment funds: approximately 90 investment funds, about half of which were speciality funds, invested a total of around €235 million, either in certificates with exposure to Madoff or in foreign investment funds which themselves were direct victims of the fraud scheme. In terms of volume, a total of less than 5% of the funds in the majority of German investment companies concerned is invested in one or more foreign funds or certificates directly affected by Madoff.

## 6.3 Real estate funds

### Impact of the financial crisis

Although the asset management companies managing German real estate funds recorded net cash inflows of just over €5.9 billion in the first eight months, dramatic outflows in the funds sector occurred in October. In particular, the high levels of cash outflows were caused by the actions of institutional investors whose need for liquidity had increased as a result of the market distortions and who redeemed their shares at short notice.

● Daily reports on fund assets.

Since the beginning of October, German asset management companies have had to report the cash in- and outflows for all 45 real estate retail funds to BaFin on a daily basis. This provides BaFin with an up-to-date overview of the economic situation of the separate assets funds in question.

In addition, BaFin responded to various negative reports on the performance of individual foreign real estate markets by obtaining from companies whose real estate retail funds were significantly invested in these markets information on how they assessed their current situation and outlook.

● Redemption freeze for open-ended real estate funds.

As a result of the huge number of share redemptions, ten companies were forced to suspend the redemption of shares at a total of twelve real estate retail funds due to insufficient available liquidity (section 81 InvG).<sup>48</sup> This corresponds to just under 40% of the total assets in the funds sector. With one exception, the suspension period for all companies had initially been three months in each case; for one company, it had been six months. The issuing of shares remains possible, however. Two of the funds were re-opened at the end of January 2009.<sup>49</sup> The companies extended the redemption suspension by up to nine months with respect to eight real estate retail funds.

● Operation of payment plans prohibited.

Against this background, BaFin checked whether payment plans from separate assets funds could continue to operate after the redemption of shares had been suspended. A number of companies continued to operate the plans despite the redemption freeze. However, BaFin regards this as incompatible with the principle of the equal treatment of investors and thus as inadmissible under investment law. It thus prohibited the operation of payment plans from fund assets. One asset management company made an objection in this respect and applied to the Frankfurt Administrative Court for interim legal protection. The court, however, confirmed BaFin's interpretation of the law in a ruling at the end of December 2008.<sup>50</sup> Insofar as asset management companies' assets are used for the payment plans, no objections can be raised under supervisory law.

### General development of open-ended real estate funds

As at the end of 2008, 46 real estate retail funds (2007: 45) with assets of €85.4 billion (2007: €84.7 billion) were managed by German asset management companies alongside 123 specialised investment funds in the form of real estate separate assets funds (2007: 118) with assets of €23.2 billion (2007: €21.3 billion).

<sup>48</sup> KanAm US-grundinvest Fonds (27.10.2008), KanAm grundinvest Fonds, AXA Immoselect, TMW Immobilien Weltfonds (28.10.2008), Focus Nordic Cities, SEB ImmoInvest (29.10.2008), Morgan Stanley P2 Value, UBS (D) Euroinvest Immobilien, UBS (D) 3 Kontinente Immobilien (30.10.2008), CS EUROREAL, DEGI EUROPA, DEGI INTERNATIONAL (31.10.2008).

<sup>49</sup> DEGI INTERNATIONAL, Focus Nordic Cities.

<sup>50</sup> Ref.: 1 L 4252/08.F (V).

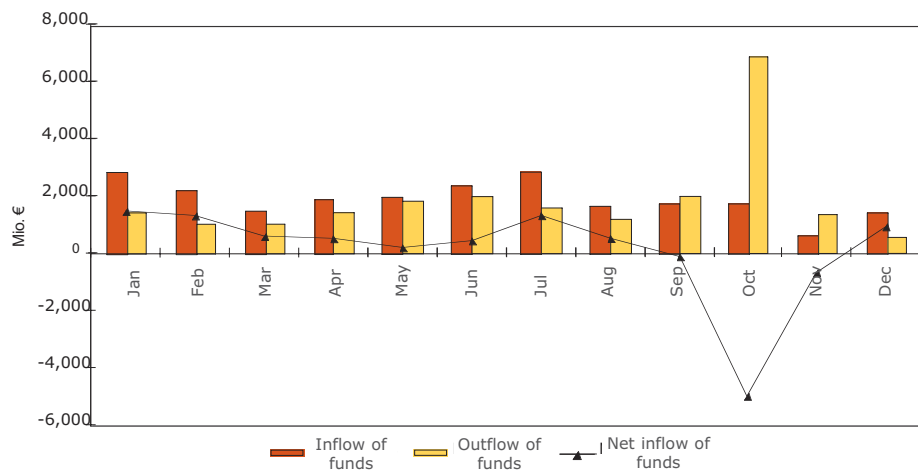
Financial crisis has dramatic impact on inflow of funds.

In the year under review, BaFin authorised one company to operate real estate fund business. The company will concentrate on business with institutional investors. Thus the trend of the past few years, i.e. the establishment of new asset management companies whose business policy is oriented towards institutional investors, appears to be continuing.

The inflow of funds in open-ended real estate retail funds was very mixed in 2008. Whilst it seemed as if the positive trend of the previous year was continuing in the first three quarters, with a net cash inflow of just over €5.7 billion, October saw dramatic outflows, which peaked at the end of the month with a net cash outflow of just under €1 billion. Investors withdrew a net total of almost €5.1 billion from real estate retail funds in October. In other words, almost the entire net cash inflow from the first three quarters had been wiped out within the space of a single month. In November, on the other hand, the net cash outflows from real estate retail funds slowed sharply, and in December, at just under €0.9 billion, the funds group recorded a net cash inflow again. Overall, real estate retail funds thus recorded modest net cash inflows amounting to just under €1 billion for 2008.

Figure 29

### Inflow of funds into real estate retail funds 2008



The average annual performance of open-ended real estate retail funds worsened year-on-year, down from 5.7% to 4.7% according to the BVI method (comparison of redemption prices). The decline of around 1% in average performance occurred primarily against a background of falling prices on the global real estate markets. In the year under review, open-ended real estate funds were not entirely immune to this general market trend either.

## 6.4 Hedge funds

Alternative investments, too, felt the global shockwaves of the financial crisis. A large number of hedge funds worldwide may not survive this crisis. However, German hedge funds have so far shown themselves to be comparatively resilient and some were even able to achieve positive yields, although three funds of hedge funds did withdraw from the market due to a lack of investor interest.

### Tighter regulation demanded.

As a consequence of the global financial crisis, demands to subject hedge funds, too, to stricter regulation have emerged. At the summit of G20 world leaders in Washington in November 2008, debate therefore focused in particular on hedge funds. In their final declaration, world leaders demanded a general tightening of regulatory requirements and risk management in order to ensure that all financial markets, products and participants are regulated or subject to appropriate supervision. Hedge funds are also the subject of ongoing discussions at European level. According to a European Commission announcement, a proposal for a Directive on alternative investments including hedge funds will be put forward in April 2009.

As in the previous year, the total number of single hedge funds and funds of hedge funds established under German law remained stable at a low level. BaFin authorised five new single



hedge funds in 2008; three German funds of hedge funds and one foreign fund of hedge funds licensed for distribution in Germany relinquished their licence.

The newly authorised single hedge funds are predominantly company sub-funds from public investment companies. As at the end of 2008, therefore, a total of 30 German single hedge funds (four of which are speciality funds; 2007: 25) and ten German funds of hedge funds (of which two are speciality funds; 2007: 14) have been approved. In addition, four foreign funds of hedge funds are licensed to distribute their shares publicly in Germany (2007: 7).

According to information from the sector, approximately €1.3 billion is invested in hedge funds authorised in Germany (2007: €2.1 billion).

### Supervisory visits and annual meetings.

In the year under review, BaFin carried out six on-site supervisory visits and annual meetings, including at all the companies which had applied for authorisation in 2008 to set up a hedge fund. Supervisory visits improve communication between BaFin and the undertaking under supervision and thus assist the former in making a sounder assessment of the latter. This regular contact helps BaFin to gather the information it needs quickly and effectively in times of crisis.

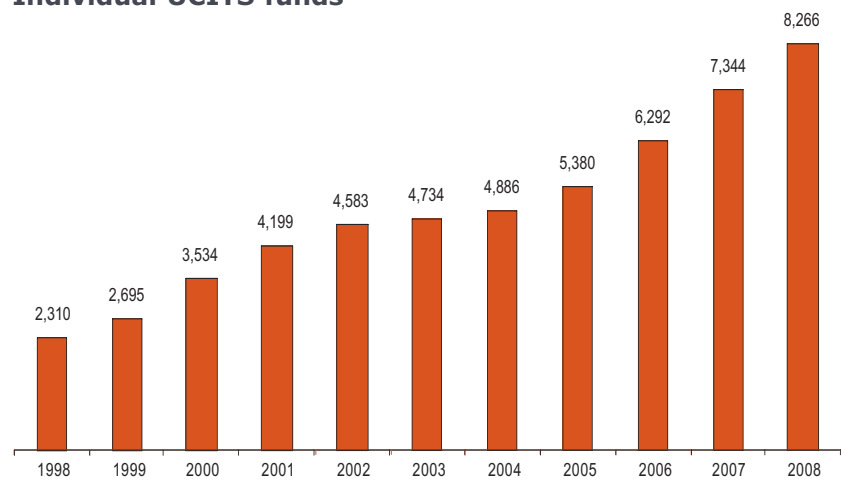
## 6.5 Foreign investment funds

### UCITS investment funds

In 2008 BaFin processed 1,540 (2007: 1,505) new notifications for the distribution of investment funds complying with the relevant EU Directives (UCITS funds). As in previous years, the largest number of notifications issued concerned funds from Luxembourg and the Republic of Ireland. Notifications were also submitted from Austria and France in particular. Despite numerous fund mergers and liquidations, the total number of foreign UCITS funds licensed for distribution rose to 8,266, an all-time high (2007: 7,344).

Figure 30

### Individual UCITS funds



New all-time high for distribution notifications.

Marketing activities.

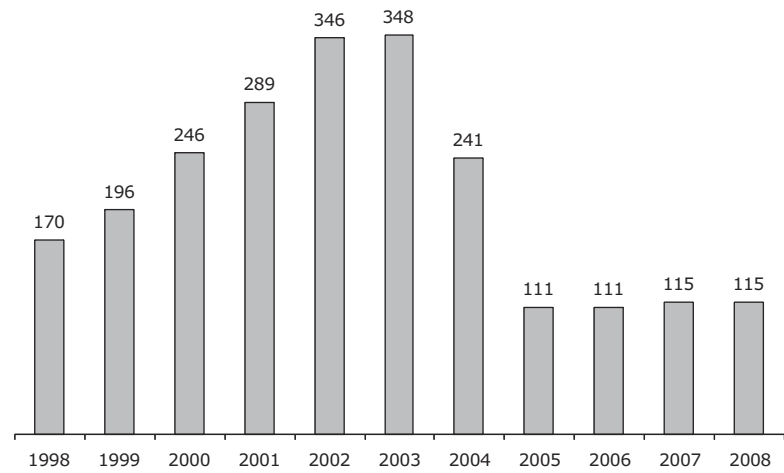
In the year under review, BaFin once again critically examined the marketing activities of individual foreign UCITS funds and prohibited three from offering any further shares in their funds to the public in Germany. In addition, BaFin answered a large number of legal queries, in particular concerning the reforms relating to the InvÄndG. Here, too, complaints focused predominantly on the performance of funds. BaFin is unable to follow up these complaints; the performance of investment funds depends crucially on the situation of the capital markets.

### Non-UCITS investment funds

In comparison with the previous year, the number of non-UCITS individual funds licensed for distribution remained unchanged at 115, of which four are foreign funds of hedge funds, although 19 funds had waived their entitlement to public distribution. However, this was offset by the same number of new funds that successfully completed the notification procedure in 2008 in accordance with section 139 InvG and are thus licensed for distribution to the public. In contrast to the previous years, these funds originated not only from Luxembourg but also from Switzerland and Austria. For the first time, a foreign open-ended real estate fund was also licensed for distribution.

Number of funds licensed for distribution unchanged.

Figure 31

**Individual non-UCITS funds\***

\* From 2006 onwards, the statistics also include foreign funds of hedge funds licensed for distribution.



## VII Cross-sectoral responsibilities



Michael Sell,  
Chief Executive Director of  
Cross-Sectoral Issues/Internal  
Administration

### 1 Deposit guarantee, investor compensation and protection funds

#### **Reform of the Deposit Guarantee and Investor Compensation Act**

BaFin supervises all statutory compensation funds and schemes which protect institutions in the field of banking and securities trading. It also monitors the statutory protection funds for life and substitutive health insurance. Based on the Deposit Guarantee and Investor Compensation Act (Einlagensicherungs- und Anlegerentschädigungsgesetz – EAEG), the Banking Act and the Insurance Supervision Act as well as various financing regulations, BaFin's supervision deals with serious deficiencies which could jeopardise the proper execution of the duties of these institutions or their assets. Insofar as compensation funds and protection funds adopt administrative acts such as contribution notifications, BaFin also rules on the corresponding objections from the member institutions of these funds.

At the beginning of 2009, the Federal Cabinet decided on a reform of the EAEG, which is set to be approved by the Federal Parliament by summer 2009. The reform of the EAEG will see the implementation of EU provisions on the revision of the EU Deposit Guarantee Schemes Directive. Responding to the ongoing crisis on the financial markets and the difficulties experienced by financial institutions, the European Commission submitted a proposal for the amendment of the EU Deposit Guarantee Schemes Directive on 15 October 2008. Essentially, the amendments to the Directive concerned an increase in the level of protection and a reduction of the payout period.

In order to improve consumer protection and the financial market stability, the bill provides for deposits to be guaranteed by law to a maximum of €50,000, up from the previous limit of €20,000. A further increase to €100,000 is then set to take place on 31 December 2010. In addition, the current system whereby the depositor bears 10% of any losses is to be abolished and the payout period for compensation is to be reduced to a maximum of 30 days.

In line with consumer protection, these measures will ensure that the majority of private deposits in Germany are guaranteed by law in their entirety. They are intended to increase private investors' confidence in the security of their deposits and prevent an uncontrollable situation in which investors withdraw their deposits en masse from crisis-hit institutions and thus trigger the insolvency of institutions that had run into difficulties.

The bill also provides for improved regulations concerning the early detection of risks and the prevention of losses. In future, the compensation funds are to conduct better audits of the institutions. The intensity and frequency of the audits performed by the funds are to depend on the institutions' potential default risk. Furthermore, the compensation funds are obliged to introduce a contributions levy that is even more specifically geared to the default risk of individual member institutions. The regulations governing the special contributions levy and the raising of credit are being further developed and finalised by the compensation funds. To this end, and to finance the compensation funds' higher level of protection, the contribution regulations of the statutory compensation funds must undergo radical reform. In close collaboration with the Bundesbank, BaFin submitted corresponding drafts to the BMF.

### Compensation proceedings in the case of Phoenix

2008 saw BaFin continuing to focus on the compensation proceedings in the case of Phoenix Kapitaldienst GmbH (Phoenix).<sup>51</sup>

The Compensation Fund of Securities Trading Companies (Entschädigungseinrichtung der Wertpapierhandelsunternehmen - EdW) was unable to produce a concrete calculation of the compensation claims of all the investors concerned in 2008, as the problems relating to the claims for the separation of assets in the insolvency proceedings have still not been solved. In a ruling in February 2009, the Federal Court of Justice definitively rejected the insolvency plan. Essentially, the court's decision was based on the notion that, compared to general insolvency proceedings, this plan would have put creditors at a disadvantage. It was not possible to establish in the insolvency plan the terms under which the claims of individual creditors were to be calculated. The insolvency administrator has now declared that general insolvency proceedings are to be carried out.

However, it has been possible in the meantime to complete the work begun in 2007 to calculate partial compensation payments. The EdW intends to process the 27,500 claims notifications still pending in the order in which they were received. By the end of February 2009, the compensation fund had made partial compensation payments running into millions to hundreds of investors. In 2009, the EdW intends to pay out amounts totalling some €45 million in partial compensation payments. Financing for

● Preparations for partial compensation payments completed.

<sup>51</sup> 2007 Annual Report, p. 206.

the partial compensation payments has been secured by a loan from the Federal Government to the EdW.

- Special contributions levy examined by courts in test cases.

The interim financing for the partial compensation payments from the Federal loan had become necessary after the Berlin Administrative Court had, in a number of cases, suspended the immediate fulfillment of EdW member institutions' obligation to pay in respect of the special contributions levy. The Berlin Administrative Court justified its decision by highlighting its doubts as to the legality of the legal provisions governing the special contribution obligation. The EdW appealed against this ruling to the Berlin-Brandenburg Higher Administrative Court in a test case, as the former still regarded the special obligations levy as legitimate. The Higher Administrative Court's decision is expected in the course of 2009.

To also enable the fundamental legal questions regarding the main issue to be clarified at the same time, BaFin rejected the objections against rulings on special contributions in some of the over 600 pending objection proceedings. As expected, the institutions instituted legal proceedings at the Berlin Administrative Court. The number of test cases was kept to a minimum particularly for reasons of cost and thus served the interests of all institutions financing the EdW.

- No risk of compensation claims being statute-barred.

In the year under review, investors turned to BaFin with the question of whether there was a risk of their claims vis-à-vis the EdW being statute-barred limited, as over three years had elapsed since the case for compensation was identified. At present, there is no cause for concern. In accordance with the current legal situation, an investor's claim vis-à-vis the EdW becomes statute-barred after five years (section 3 (3) EAEG).



At the beginning of the limitation period, the EdW adopts an investor-friendly interpretation.

Accordingly, the period begins on the day on which the EdW determines the extent of the investor's individual claim and his entitlement thereto. Particularly as a result of the problems linked to the separation of assets which have not been solved definitively from a judicial point of view, the EdW has not yet been able to decide on possible compensation claims in the majority of cases. The limitation period for these submitted claims has therefore not yet begun.

## 2 Authorisation requirements and prosecution of unauthorised operations

Investors are faced with the challenge of having to choose from a bewildering array of products and providers. For this reason, it is very tempting to go for a product that promises particularly high profits. However, the promises of profits in the shape of old-age provisions, asset accumulation or tax relief often conceal high-risk products with complex structures offered by providers who operate without the necessary authorisation from BaFin. BaFin prosecutes these undertakings and thus makes an important contribution to protecting investors and to preserving the integrity of the capital market.

### 2.1 Assessment of authorisation requirements

Many providers resort to the option of allowing BaFin in advance to assess whether their intended business activity is subject to authorisation requirements under the KWG and/or the VAG. An activity that is subject to authorisation requirements may not be taken up until BaFin has issued a written authorisation. BaFin is entitled to order providers conducting business without the necessary authorisation to cease these activities immediately, request the reversal of transactions and publish the corresponding orders on the Internet (section 37 KWG). Furthermore, an undertaking conducting unauthorised operations also runs the risk of a criminal prosecution, as a violation of the statutory authorisation requirement is liable to prosecution.

● 410 enquiries regarding authorisation requirements.

In the year under review, BaFin examined 410 enquiries concerning the authorisation requirements of planned business ventures. 382 of these enquiries concerned the KWG and 28 the VAG.

● New Guidance Notices on a number of banking operations.

BaFin has published up-to-date Guideline Notices on the different banking operations subject to authorisation requirements, which contain basic information on the individual definitions. The Guideline Notices are designed to allow undertakings wishing to operate on the capital market, their advisors and other interested parties to carry out an initial assessment as to whether a particular business activity is to be considered as a banking operation subject to authorisation requirements as defined by the KWG. However, the Guideline Notices make no claims to represent an exhaustive description of all the issues affecting each definition. In particular, they do not replace the submission of a case-specific authorisation enquiry to BaFin. To be able to make a definitive assessment of potential authorisation requirements in individual cases, BaFin requires all the relevant documents concerning the contractual arrangements underlying the conduct of any banking operation.

BaFin plans to publish further Guideline Notices on financial services subject to authorisation requirements.

## 2.2 Exemptions

● Exemption from supervision.

An undertaking which, due to the type of business activities it operates, does not require supervision by BaFin, can be exempted from authorisation requirements in individual cases. Typically, this applies to business activities which an undertaking conducts only as a minor auxiliary or secondary operation or which are necessarily linked to a business activity which is, in itself, exempt from authorisation requirements. 19 undertakings were exempted from supervision for the first time in the year under review; at year-end, a further 56 applications had been submitted to BaFin. A total of 291 institutions were thus exempt from authorisation requirements at the end of the year under review.

It is also possible for providers from non-EU third countries to be exempted from authorisation requirements. They can apply for an exemption in order to operate in Germany on a cross-border basis provided that they are subject to equivalent supervision in their home country. BaFin exempted a total of six foreign undertakings in the previous year.

● E-money institutions eligible for special exemption.

Undertakings which exclusively operate e-money business can apply for exemption in accordance with section 2 (5) KWG. In the year under review, BaFin exempted one institution on this basis for the first time. As at the end of 2008, therefore, a total of eight undertakings were exempt; one further application had been submitted to BaFin.

## 2.3 Black capital market

BaFin uses the term "schwarzer Kapitalmarkt" ("black capital market") to describe banking, financial services and insurance operations which are conducted without the necessary authorisation under the terms of the KWG or VAG. BaFin acts against such operations in collaboration with the Bundesbank. It clarifies the underlying contractual relationships, the precise course and the scope of the operations. In its investigations, BaFin can search the business premises of undertakings under suspicion and seize documents. In this process, BaFin also cooperates with the police and public prosecutors. Combating the black capital market in a consistent manner is essential if the integrity of Germany as a financial centre is to be preserved. It is an active form of investor protection.

● BVerwG ruling on collective investment models.

In the past, BaFin took action against collective investment models, whereby the investors participated in the performance of the financial instruments acquired with the invested funds – via the bonds or participation certificates issued by the providers in the case of structures governed by the law of obligations, largely via a

trustee acting as limited partner in the case of Kommanditgesellschaften (German limited partnerships). Here, BaFin saw this as the unauthorised operation of financial brokerage business under the terms of section 1 (1) sentence 2 no. 4 KWG. Both the Frankfurt Administrative Court and Hesse Administrative High Court had initially confirmed this view in numerous rulings. However, after a change was made regarding the court having jurisdiction in Frankfurt, the rulings of October 2005 by the Frankfurt Administrative Court and of February 2006 by the Hesse Administrative High Court triggered a U-turn in legal practice.<sup>52</sup>

In its verdict of 27 February 2008 with regard to a model structured under the law of obligations, the German Federal Administrative Court (Bundesverwaltungsgericht – BVerwG) ruled that this model did not constitute financial brokerage business.<sup>53</sup> The provider of this model had issued “certificates” designed as bonds. The investors’ entitlement to a payout on the return of the certificates to the provider was based on the development of a portfolio held by the provider and selected by the investor, in which the former traded in financial instruments. Although the BVerwG recognised that the administrative practices of BaFin would possibly better serve the interests of investor protection, it considered them to be incorrect for reasons relating to the legal system.

The BVerwG has yet to reach a decision on trusteeship/limited partnership models under company law, in which investors are to participate in a limited partnership’s trade in financial instruments via a trustee acting as limited partner. It is unclear how the BVerwG will rule in these cases, because it is only possible to compare the trusteeship/limited partnership models with the models on which the BVerwG ruled in February 2008 to a limited extent, if at all.

 New statutory definition for asset management.

By introducing a new statutory definition, the legislator has closed the legal loophole revealed by the BVerwG ruling. The Act on the Continuing Development of Pfandbrief Law, which entered into force on 26 March, incorporated the new definition of asset management as a financial service into the KWG. In accordance with this act, authorisation from BaFin is required for the purchase and sale of financial instruments on behalf of a group of investors – consisting of natural persons – as long as the provider has scope for decision-making in the selection of financial instruments. Furthermore, this activity must form a main focus of the product offered and must be conducted with the objective of allowing investors to participate in the performance of the financial instruments acquired.

For the purposes of investor protection and to preserve the integrity of the financial market, the new definition has provided a secure legal basis for authorisation requirements for the investment models concerned. It covers those cases which, after the change in legal practice, fall (and will possibly continue to fall) outside the scope of financial brokerage business.

<sup>52</sup> Ref.: 1 E 1159/05 [V], ZIP 2006, 415; ref.: 6 TG 1447/05, ZIP 2006, 800.

<sup>53</sup> Ref.: 6 C 11.07, 6 C 12.07, BVerwGE 130, 262.

### Supervisory and investigation measures

● A total of 401 new investigations.

BaFin initiated a total of 401 new investigations in 2008. The majority of these involved unauthorised banking and financial services operations; 29 proceedings were initiated due to the unauthorised conduct of insurance business. BaFin approached 65 undertakings under suspicion with formal requests for information and the presentation of documents, and imposed 21 fines. 17 on-site inspections and searches were carried out as part of the investigations.

● 15 prohibition and 11 winding-up orders.

Only if the provider is not prepared to cease his unauthorised business activity voluntarily will BaFin intervene formally against him. In the year under review, it issued 15 prohibition orders and 11 winding-up orders. A liquidator was appointed in one case. BaFin can also act against persons and undertakings implicated in the initiation, conclusion and settlement of the unauthorised business of third parties. This group does not only consist of undertakings that implicate themselves deliberately in such operations but also includes those which contribute unwittingly to the conduct of unauthorised operations while performing their regular services. For instance, these can be Internet service providers or other providers of telecommunications services. BaFin exercised these powers in nine cases in the year under review by issuing prohibition orders or instructions.

### New kind of international administrative assistance

More and more frequently, unauthorised investment business is spread across different countries to make it as difficult as possible for the authorities responsible to uncover the facts. International administrative assistance, made possible via an amendment to the KWG in 2007, helps out here.

In the year under review, BaFin searched the premises of German undertakings as part of this administrative assistance for the first time – at the request of the Swiss Federal Banking Commission (Eidgenössische Bankenkommision – EBK), now the Swiss Financial Market Supervisory Authority (Eidgenössische Finanzmarktaufsicht – FINMA). These undertakings were suspected of being implicated in the transactions of a Swiss undertaking which had been prohibited from conducting deposit business by the EBK. The searches were intended to clarify whether funds deposited at the undertaking were or had been managed by third parties domiciled in Germany. BaFin hopes that this new kind of administrative assistance will catch on at other supervisory authorities and will improve international cooperation in the fight against the black capital market.

● Appeals against BaFin measures.

In 60 cases in the year under review, individuals or undertakings against which BaFin had imposed formal measures lodged an appeal. BaFin concluded 87 objection proceedings in the same period. 59 proceedings were settled after providers disclosed the required information, submitted the relevant documents or withdrew their objection, for instance. A notification on the objection was issued in 28 cases. All notifications on objections contained a full repudiation of the objection.

Often those affected by measures imposed by BaFin also take legal action. Out of a total of 98 disputes that came before the courts, a decision was reached in 41 cases in the year under review, of which 33 were settled in favour of BaFin. In eight cases, the courts upheld the appeal of the affected parties.

## 3 Prevention of money laundering

### 3.1 International money laundering prevention and national legislation

#### ● Circulars on Iran and Uzbekistan.

In the year under review, the Financial Action Taskforce on Money Laundering (FATF) identified serious deficiencies in the prevention of money laundering and the fight against the financing of terrorism in Iran and Uzbekistan. Both countries offered only a very limited degree of cooperation in this area. The FATF highlighted these deficiencies in public statements and warned of the risks involved in conducting business with Iran and Uzbekistan. BaFin then issued two circulars on the implementation of these statements. A BaFin representative also participated in a high-level FATF mission to Uzbekistan in order to persuade the country to cooperate. Uzbekistan agreed to comply with the international standards governing the prevention of money laundering in future.

#### ● BaFin dispatches auditors to two FATF mutual evaluations.

In the year under review, a BaFin representative took part in two mutual evaluations of money laundering in Estonia and Japan. These evaluations are designed to ensure that the FATF's 40 recommendations on the fight against money laundering and its nine special recommendations on the prevention of the financing of terrorism are being implemented correctly. The evaluation team held numerous discussions with the police and with public prosecutors, ministries, financial market supervisory authorities and private market participants. They then forwarded their revised report to the delegations from the member countries for consultation and approval at the appropriate plenary sessions of the organisations. Next year, the International Monetary Fund will carry out the mutual evaluation for Germany on behalf of the FATF. The on-site evaluation is scheduled for the second half of May.

At the end of October, BaFin organised a so-called 3L3 seminar for CEBS, CEIOPS and CESR, the committees of the European supervisory authorities. The seminar dealt with the areas of money laundering and the financing of terrorism as well as unauthorised business. In the course of two days of talks and workshops, the participants from 14 countries discussed the main challenges regarding the new money laundering standards and the powers of investigation available in the case of unauthorised business.



● New laws on the prevention of money laundering.

The Act amending the Money Laundering Act (Geldwäschebekämpfungsergänzungsgesetz) entered into force at the beginning of August 2008. The act is a complete revision of the existing Money Laundering Act (Geldwäschegesetz – GwG) and changes or supplements numerous additional regulations in money laundering law, in particular in the KWG and VAG. BaFin followed the entire legislative process closely.

In terms of its content, the act fine-tunes the previous regulations on due diligence in terms of money laundering law. With the new regulations, the legislator has also made allowances for the particular money laundering risks connected with cash transactions within the context of financial transfer and foreign notes and coin business. The obligation to provide proof of identity for all cash transactions in financial transfer business – except for the payment slip transactions of credit institutions – has thus been established. For cash transactions involving foreign notes and coin, the act has introduced a threshold of €2,500.

Overall, the due diligence requirements under money laundering law as laid down in the GwG are now geared more closely to the relevant risks. If money laundering risks increase, so do the requirements of due diligence. If they decrease, less stringent requirements apply accordingly.

● ZKA publishes guidelines on interpreting and applying the law.

In December 2008, the Central Credit Committee (Zentraler Kreditausschuss – ZKA) published guidelines on interpreting and applying the new Act amending the Money Laundering Act. This had been coordinated with BaFin and the BMF and provided the banking industry with advice in note form on how to interpret and apply the statutory regulations and recommendations above and beyond the legislative background. The ZKA plans to expand and fine-tune these initial guidelines and issue them in the form of a detailed practical guidance paper. It is aiming to publish an outline of the guidance paper in the course of 2009. Other associations have already announced their intention to coordinate with BaFin supplementary interpretation and application advice specific to their field.

● New supervision of leasing and factoring institutions.

In December 2008, the legislator placed finance leasing and factoring, as financial services subject to authorisation requirements, under the supervision of BaFin in accordance with the KWG and GwG.<sup>54</sup> Undertakings which buy receivables on the basis of framework agreements (factoring) on an ongoing basis or offer finance leasing now need authorisation from BaFin and are subject to its money laundering supervision. Even before the current change in the law, providers of factoring and finance leasing services had to comply with the GwG and implement measures against money laundering. Responsibility for money laundering supervision now passes from the bodies responsible under federal state law to BaFin. BaFin will first obtain an overview of the current state of money laundering prevention and the general risk situation and will then proceed to adapt supervisory standards accordingly.

<sup>54</sup> See Chapter V.1.4

### 3.2 Prevention of money laundering at banks, insurers and financial services providers

Special audits at banks reveal shortcomings.

BaFin undertook eight special audits in 2008 to investigate whether credit institutions had introduced the required measures for the prevention of money laundering. As in previous years, these revealed shortcomings, for instance in risk analysis and in the group-wide implementation of money laundering measures.

BaFin employees also participated in 14 annual audits in order to gain on-site experience of the practice of investigating preventative measures against money laundering and the financing of terrorism. The institutions and auditors, too, made use of the opportunity to discuss questions and problems. It became clear that there was a particular need to discuss the new regulations under money laundering law which the institutions are to implement.

Insurers to introduce ongoing monitoring for premium payments.

A money laundering case in the insurance sector which surfaced in 2008 confirmed the opinion held by BaFin that, for the prevention of money laundering to be effective, undertakings should also, as appropriate, permanently monitor the mode of payment used for premiums. In accordance with the new regulations under money laundering law, the continuous monitoring of business relationships now forms part of an undertaking's general due diligence requirements.

The measures introduced by BaFin, e.g. the demand for increased due diligence requirements for transfers to specific countries, have proved successful in the fight against phishing. The phenomenon of financial agents, however, has still not been eliminated. The changing patterns as regards transactions show that computer fraudsters are still looking for phishing-related ways to obtain funds via financial transfer services providers.

## 4 Account access procedure and account blocking

Account access procedure helps investigating authorities and BaFin.

As in previous years, many investigating authorities made use of the option to access account information in accordance with section 24c KWG. In some cases, this was done directly for the benefit of the banks. For instance, a police authority in Bremen working together with BaFin succeeded in putting a stop to the operations of a credit fraudster.

BaFin itself also used the account access procedure to prosecute unauthorised banking or financial services operations and in the fight against the financing of terrorism. In October 2008, BaFin was therefore able to investigate the various accounts held by a 23-year-old German citizen strongly suspected of having been a member of a terrorist organisation. The accounts were blocked under the terms of section 6a KWG.

Account access procedure undergoes technical restructuring.

The procedure for the automatic accessing of account information was technically modified in 2008. The introduction of a new interface specification enabled a significant reduction in the processing time required to access an account. At the same time, a better enquiry logic was implemented. As a result of these improved search strategies, the hit rate, i.e. the number of account enquiries with hits compared to the total number of account enquiries, rose steadily. Whereas BaFin investigated one or more accounts in 66% of enquiries in 2005, subsequent years saw a continuous rise in this rate to its current figure of 78%.

BaFin processes 83,938 enquiries.

Overall, BaFin processed 83,938 enquiries, a lower total than that recorded a year earlier (93,560). The reason for this is that the account access procedure was out of action for a time due to the technical changeover in the first half of the year. At 50,800, the number of enquiries processed in the second half of the year reveals a continuing upwards trend, however.

In the account access procedure, BaFin provided information on approximately 753,000 accounts (previous year: 817,000).

The recipients of the accessed account information and the trends regarding the volume of enquiries from these authorised agencies are shown in the following table.

Table 28

#### Authorised agencies in 2008

Authorised agency	2008		2007	
	absolute	in %	absolute	in %
BaFin	277	0.3	472	0.5
Tax authorities*	10,936	13.0	13,061	14.0
Police authorities	46,132	55.0	54,111	57.8
Prosecution authorities	18,520	22.1	18,002	19.2
Custom authorities*	7,604	9.1	7,167	7.7
Others	469	0.6	747	0.8
<b>Total</b>	<b>83,938</b>	<b>100</b>	<b>93,560</b>	<b>100</b>

\* The tax and customs authorities are only authorised to have BaFin perform account enquiries in accordance with section 24c KWG with respect to criminal proceedings.

## 5 Certification of housing Riester products

Housing Riester offers more options.

In 2008 the legislator added the element relating to the promotion of home ownership to the Act governing the Certification of Contracts for Private Old-Age Provision (Altersvorsorgeverträge-Zertifizierungsgesetz – AltZertG) and integrated owner-occupied residential properties into the Riester subsidised pension scheme. At the heart of the amendment to the AltZertG – effected by means of the Home Ownership Pensions Act (Eigenheimrentengesetz) adopted in mid-2008 – is the recognition for tax purposes of redemption payments in the financing of a loan for an owner-occupied property. This also applies for pre-financing loans and combined savings and loan contracts.

● BaFin certifies 472 products.

The BaFin Certification Office certified the first so-called Wohn-Riester ("Housing Riester") products in 2008. Immediately after the law was promulgated, providers submitted applications for certification of the new housing Riester products. After numerous general policy matters had been settled, the Certification Office issued the first housing Riester certificates for 435 products from banks and 27 from building societies at the same time on 1 November 2008. BaFin was also able to certify a further ten certificates in 2008. Applications for these were later mainly submitted by life insurers. These products, too, continue to benefit from the retroactive tax privilege for the whole of 2008.

● 25 aspects of a contract examined.

During the certification process for the new Riester products, BaFin verifies whether a contract meets the requirements of the AltZertG and is thus eligible for tax breaks. To this end, the Certification Office examines up to 25 separate aspects of a contract. For instance, it looks into the questions of whether the transaction and distribution costs set are distributed correctly, whether there is a nominal premium maintenance guarantee and whether the investor rights prescribed by law are protected. In the case of the housing Riester products, the subsidised capital must be used to finance residential property. Within the scope of this specific duty, however, BaFin does not monitor whether a contract for private old-age provision is economically sustainable, whether the provider's commitment can be met or whether the contractual conditions are effective under civil law before it issues its certificate for private old-age provision.

When the AltZertG was promulgated, BaFin uploaded on to its website special application forms and checklists for providers in order to ensure that the certification process is fast and transparent. A list of certified products for private old-age provision, which is updated on an ongoing basis, is also available there to help consumers.

## 6 Consumer complaints and enquiries

In 2008, 22,408 customers (2007: 20,852) from insurers and credit and financial services institutions submitted complaints, enquiries or advice to BaFin.

BaFin helps individual customers as much as possible, for instance by intervening at the undertaking to correct an error or by explaining the legal situation in an easily comprehensible way.

If an institution or undertaking is in breach of supervisory regulations, BaFin issues a warning and requests that measures be taken to prevent future violations. If there are any organisational

shortcomings, BaFin works towards an organisational restructuring and then monitors its implementation.

To protect themselves against fraud, unsound products or the total loss of their invested capital, investors should themselves examine very closely the soundness and the economic plausibility of the offers in which they are interested. Unfortunately, there is no secure form of protection against insolvency or criminal acts.

### Consumer Helpdesk

To obtain information and advice, many consumers use the BaFin Consumer Helpdesk by calling 01805 122 346. Consumers can obtain information on supervisory activities, the basic complaint procedure and the status of their complaint. From its launch on 1 March 2006 to the end of 2008, 79,300 consumer enquiries were received. 31,400 of these enquiries came in 2008 and 24,600 in 2007.

Over half of callers asked questions about the insurance sector. 30% of consumers called regarding banks and building societies. 10% of enquiries concerned securities supervision. With regard to many consumer issues, the BaFin Consumer Helpdesk is one of the first ports of call. The financial crisis and, in particular, the moratorium on the Germany branch of Kaupthing on 9 October led to a significant increase in consumer enquiries received by the Helpdesk. In October 2008 alone, more than 5,200 enquiries were received from consumers. The monthly average is around 2,300 calls.

## 6.1 Complaints relating to credit institutions and financial services providers

In the year under review, BaFin processed 5,330 complaints relating to credit and financial services institutions (previous year: 3,643). It submitted official opinions on 37 complaints made to the Petition Committee of the German Bundestag. 462 general enquiries not related to particular institutions were also made. As far as the customers were concerned, 633 complaints and three petitions were either wholly or partially successful.

### Selected cases

Very many complaints in 2008 concerned the moratorium with respect to Kaupthing Bank and the problems it caused. More than 1,200 letters were received on this issue alone. This led to a marked rise in the number of complaints. Customers of Kaupthing Bank asked how they could assert their claims and when they could expect to be repaid. Questions were also asked regarding transfer orders for payments which had been charged to Kaupthing

● 1,200 complaints about Kaupthing Bank alone.

Bank accounts from late afternoon on 8 October 2008 onwards but which had not been transmitted onwards due to the events of 9 October 2008. The customers were informed that the payments had not left Kaupthing Bank and should be claimed from the Icelandic deposit guarantee fund.

● Arrangement fee for buildings savings plans.

A further key issue concerned the legality of arrangement fees in the case of buildings savings plans. After it had become clear from the relevant literature that the charging of arrangement fees for buildings savings plans was illegal under General Business Conditions law, many customers approached BaFin with the aim of having the fee refunded. The building societies refused to repay the fees. BaFin shared their opinion that appropriate arrangement fees for buildings savings plans were legitimate. The Verbraucherzentrale Nordrhein-Westfalen (North Rhine-Westphalia Consumer Advice Centre) wants to obtain clarification from the highest judicial authority on the legality of the arrangement fee as well as the loan fee calculated for the disbursement of a loan. It filed complaints against three institutions. In one case, Heilbronn Regional Court, as the court of first instance, rejected the complaint from the Verbraucherzentrale.<sup>55</sup>

● Bank customers worried by the sale of loans.

The uncertainty amongst bank customers regarding the impact of the sale of a loan on the continuation of the loan contract continued to be observed in 2008, albeit to a much lesser extent than in the previous year. The correspondence was based on just a few actual cases relating to the processing by the purchaser of the receivable. Rather, the correspondence was the expression of a general loss of confidence.

The legislator responded to the discussions with the Risk Limitation Act (Risikobegrenzungs-gesetz) and bolstered consumer rights in the case of loan sales in the year under review. Banks must now inform the customer in the loan contract of the possibility of a change of creditor and they are now liable, regardless of negligence or fault, for all losses experienced by the customer arising from unjustified enforcement measures by a new creditor.

● Institutions block cash machines for credit cards of direct bank customers.

Around 250 bank customers of direct banks complained about the blocking of their VISA credit card when using particular cash machines. Particularly in eastern and south-western Germany, many savings banks and some cooperative banks blocked the use of VISA cards of this type in their cash machines from August 2008. Thus customers of direct banks were only able to use the cash machines belonging to different institutions to a limited extent, if at all. The direct banks had advertised that their VISA credit card could be used to withdraw money from cash machines throughout Germany or even worldwide.

The savings and cooperative banks justified the block on the grounds that the option of use would give their competitors a competitive advantage. They claimed that the cost incurred was not covered by the transaction fee which they received from VISA.

<sup>55</sup> Ref.: 6 O 341/08 Bm.

They invoked the VISA code of practice which permits the selective restriction of use for cash machines.

BaFin is unable to intervene in this conflict because it is purely a civil dispute. After one direct bank appealed successfully, one savings bank had to permit the use of its cash machines once again. The outcome of other proceedings is pending.

● Property valuation fee in loan contracts.

A number of building society savers and bank customers approached BaFin in the year under review in order to have the property valuation fee relating to loan contracts reimbursed. To this end, they invoked a decision reached by Stuttgart Regional Court, which had prohibited a building society from using a corresponding clause. After BaFin had stepped in, many undertakings repaid the fee to the complainants. Since then, some other building societies and other credit institutions stopped charging the fee.

● No indications of a crisis-induced "credit crunch".

In 2008, BaFin received a number of complaints from bank customers objecting to credit institutions setting what the customers regarded as excessively strict criteria for credit checks. BaFin looked into every one of these complaints but was unable to find any indications that these cases were a manifestation of a "credit crunch" caused by the financial crisis.

## 6.2 Complaints relating to insurance undertakings

The 15,111 items of correspondence processed by BaFin in 2008 represent a very similar figure to the previous year (15,425).

These consisted of 12,767 complaints, 844 general enquiries not relating to a complaint and 90 petitions which reached BaFin via the German Bundestag or the BMF. There were also 1,410 items of correspondence which covered issues outside BaFin's area of responsibility.

Overall 31.5% of cases (previous year: 33.0%) were decided in favour of the complainant, 59.2% of complaints were unfounded, and 9.3% of cases fell outside BaFin's area of responsibility.

Table 29

### Complaints received by insurance class (since 2004)

Year	Life	Motor vehicle	Health	Accident	Liability	Legal expenses	Building/Household	Other classes	Other complaints*
2008	4,939	1,600	2,159	870	949	1,004	1,387	569	1,634
2007	4,919	1,687	1,924	973	1,144	1,045	1,532	505	1,696
2006	6,243	1,923	2,201	1,119	1,251	1,280	1,535	621	1,502
2005	5,858	1,896	2,604	1,242	1,268	1,437	1,408	359	1,459
2004	8,119	2,518	4,162	1,413	1,577	1,474	1,824	518	1,504

\*Incorrect addresses, brokers, etc.

The largest proportion of complaints (32.3% as against 32.9% in the previous year) related to claims processing or settlement in life and non-life insurance. This was followed by complaints regarding the handling of contracts at 26.1% (27.1%), the termination of contracts at 15.9% (16.1%) and business conduct when negotiating contracts at 10.5% (9.2%). In addition, 13.7% (13.6%) of complaints fell into the "Other" category. Specific provisions of the law regarding proof of age concerned 1.3% (1.1%) of complaints. The main grounds for complaint are shown in the following table.

Table 30

### Grounds for complaint

Grounds	Number
Amount of insurance payment	2,133
Coverage issues	1,261
Advertising/advice/application processing	1,135
Surplus bonus/profit credit	1,093
Manner of claims processing/delays	1,084
Improper termination	923
Change to contract, extension	904
Proper termination	840
Other (contract handling)	780

### Selected cases

- Focus on policyholders' participation in valuation reserves.

Since the new VVG entered into force at the beginning of 2008, the legislator has provided for policyholders to participate in life insurers' valuation reserves. This new surplus component was the subject of many complaints and enquiries and thus became a key issue in terms of complaints processing.

The insurers' valuation reserves are subject to sharp fluctuations. In order to cushion these, many insurers declared a so-called base or minimum participation for contracts set to end in the following year. For policyholders, this meant that they would receive at least this declared sum when terminating their contract. If their participation in the valuation reserves available at the time of termination was above this sum, they were paid this higher amount. At the end of the year under review, it was clear that almost all life insurers no longer had any valuation reserves, meaning that the complaints were largely unfounded.

- Complaints on surrender values and surplus bonuses.

Once again, the issues of surrender value and surplus bonuses also made up a large part of complaints activities. The Federal Court of Justice had expanded its ruling on minimum surrender values to include *Versicherungsvereine auf Gegenseitigkeit* (mutual societies) and the special form of fund-linked life insurance. This led to policyholders receiving payments in arrears, which in some cases were substantial. In respect of surplus bonuses, a large number of complainants made reference to the cutbacks in regular surplus bonuses brought about by the financial crisis. Almost without exception, however, these complaints were unfounded.



● Failure to consider subscription rights.

Two parties entitled to benefit from a life insurance policy complained that they had not received their share of the maturity payment. The insurer had inadvertently paid the entire sum to the policyholder and referred the complainants back to him. The policyholder, however, refused to transfer the beneficiaries' shares to them. At the request of BaFin, the undertaking then paid out approximately €10,000 including default interest to each of the complainants.

● Complaints on the charging of a flat rate risk premium.

One health insurer charged customers wishing to switch to a newly introduced rate scheme a flat rate premium on the basic premium of the new rate, independent of potential additional benefits. This so-called rate structure premium provoked numerous complaints. BaFin doubted the legality of this flat rate risk premium in certain circumstances. It therefore objected to the levying of the rate structure premium if no risk-increasing circumstances, which would lead to a risk premium under the acceptance principles for the new rates, were documented when the policy was taken out. The insurer appealed against the administrative measure taken by BaFin. Clarification of this complex legal question, which will be legally binding, will be effected by the court responsible.

● Numerous enquiries and complaints about the modified standard rate.

The year under review again saw many enquiries and complaints in connection with the Act on the Strengthening of Competition in Statutory Health Insurance. There were a number of particular problems regarding acceptance for the modified standard rate, offered since the beginning of July 2007. For instance, issues were raised regarding the compatibility of waiting times, the possibility of carrying out a risk assessment and the option of reducing the maximum contribution for policyholders in need of assistance. There were also disagreements over whether there were preconditions for acceptance. For example, the insurers had only been required to accept for the modified standard rate non-insured persons who had most recently had private health insurance or who had never held health insurance but had to be classified under private health insurance. Through the intervention of BaFin, in many cases ambiguities could be resolved and misunderstandings could be cleared up. It was often possible to help non-insured persons to obtain insurance cover.

● Notice periods for contracts spanning more than one year.

In the property and casualty insurance sector, questions regarding the interpretation of the new VVG led to numerous complaints. These were predominantly concerned with the entitlement to terminate existing contracts with a term of several years.

Whereas previously a contract which had been concluded for a period in excess of five years could not be terminated until the end of the fifth or the end of any subsequent year and in compliance with a three-month notice period, this entitlement to extraordinary termination now applies as per the end of the third year in accordance with the new regulation stipulated in section 11 (4) VVG.

Many policyholders now demanded the termination of their previously concluded contracts with a term of several years as per the end of the third year and invoked the new regulation. As a rule, the insurers refused to terminate the contracts, referring to the observance of the notice period and to the transitional provision in Article 1 EGVVG. This transitional provision stipulates that the new VVG will not come into effect for existing contracts until January 2009.

As the insurers applied the legal situation correctly on the whole, the majority of complaints were unfounded. In a number of cases, insurers agreed to make a note of the unauthorised terminations, treating them as a subsequent termination and thereby forgoing the requirement for submitting a further notice of termination at the permitted point in time.

### 6.3 Complaints relating to securities business

● Sharp rise in complaints about securities business.

In the year under review, 1,119 written complaints were received from customers regarding credit and financial services institutions operating securities business (2007: 734). In addition to numerous telephone calls, BaFin responded to 349 written enquiries regarding securities business (2007: 223). In many cases, the complaints concerned the pricing of certificates. Often, investors also complained that they had received insufficient information from their bank regarding the risks associated with particular financial products.

● BaFin acts only in the public interest.

Customers frequently hope for support from BaFin in disputes with an institution or when asserting civil claims. BaFin is not in a position to do this, however; its duty is to safeguard the integrity and operational capability of the German financial system. For this reason, at the request of the legislator, BaFin only operates in the public interest and must refer complainants to the provisions of the civil law system or ask them to seek advice from a legal practitioner for the assertion of claims.

● Extent of required customer information.

#### Selected cases

A number of investors complained that their credit institutions had asked for a great deal of personal information when giving them advice. For instance, detailed questions were asked regarding investors' schooling and vocational training, the nature of their current income and the size and nature of their assets.



Insofar as credit institutions offering the investment advice or management of the financial portfolio require the information in order to be in a position to recommend suitable financial instruments or securities-related services, they are obliged to obtain details from customers regarding investment objectives, financial circumstances and knowledge and experience of financial instruments or securities-related services. So as to be able to determine customers' knowledge and experience of financial investments, information on their education and current and previous (relevant) occupations is generally also required. As a rule, details on the nature and extent of customers' regular income and financial obligations as well as on available assets, particularly cash assets, investments and real estate assets are required to assess their financial situation. This information is thus gathered in the interest of the investor, for only in this way can a suitable recommendation be given which takes into consideration the investor's financial situation and knowledge.

Investors are not obliged to disclose these personal details to an undertaking offering securities-related services. If, however, customers refuse to provide their personal details and information on their financial situation, they bear responsibility for their investment decisions themselves. In this case, the undertaking may not recommend any financial instruments or give any other kind of recommendation.

● Settlement of sell orders for fund shares.

Another cause for complaint was the issue of settlement in the case of the sale of shares in a fund: investors complained that a day other than the date of the sale had been used for the valuation of shares. The conditions for the issuing and redemption of shares in a fund are set out in the contractual conditions of the asset management companies. Different valuation days can therefore be used for the settlement of the sale. For instance, if the settlement is carried out based on the share value as at the next valuation day but one after receipt of the order by the asset management company, this is permissible provided that provision is made to this effect in the contractual conditions.

● Restrictions in certificates trading.

In the year under review, many investors also complained that, at times, no prices had been quoted for certificates. This meant that investors affected were unable to respond to market turmoil and were forced to forfeit their certificates.

The terms and conditions of the certificates lay down the rights and obligations existing between investor and issuer. In most cases, the issuer makes it clear in the terms and conditions that he is not responsible for prices being quoted at all times on the secondary market. Although the stock exchanges' rules and regulations do provide for such a quotation requirement, there are exceptions here too. For instance, in a specific market situation, the market maker does not have to quote any prices. First and foremost, compliance with the regulations is monitored by the trading surveillance offices of the relevant stock exchange. For this reason, it or the competent stock exchange supervisory authority is the right point of contact in the event that market makers have failed to comply with their quotation requirement. Investors can obtain an impression of the quotation quality of the relevant market makers from the information published by the stock exchanges, e.g. on any disruptions to trading caused by breakdowns in the issuer system.

Statements despite transfer of securities portfolio.

In one case, an investor received statements from his old bank concerning the purchase of securities from a saving scheme several months after transferring his securities portfolio. In addition, the bank demanded payment of the purchase price of the securities, as his account stood at zero after the transfer. Although the investor pointed out many times that the security savings scheme had long since finished and the accounts closed, the bank only stopped its postings after BaFin had intervened. BaFin also demanded major early improvements in the handling of customer complaints. The upcoming report on the annual WpHG audit will show whether the measures taken by the bank have had an effect.

Payment of kick-backs.

After the Federal Court of Justice had ordered the banking industry in December 2006 to make their customers aware of undisclosed rebates – otherwise the customers would have claims for compensation – a few investors approached BaFin because they had failed to get their banks to pay out these rebates. As under supervisory law allowances only have to be justified and disclosed, BaFin was unable to be of any further help in this instance. It is the responsibility of the civil courts to clarify the extent to which customers have a right to recovery.

Insufficient risk spreading.

In 2008 over 60 complaints were received concerning an institution which had acquired several funds for each of its customers which were largely made up of the same securities. At the same time, the institution acquired the securities for its customers directly; the level of risk spreading was therefore inappropriate. This meant that the composition of the customers' custody accounts was lopsided, as the securities that had been posted to the customers' custody accounts directly and indirectly via the various funds were disproportionately heavily weighted. Furthermore, in a number of cases the securities held in the custody accounts did not match the investment objectives set by the customer. The institution failed to respond to customers' queries. After being audited by BaFin, the institution revised its organisational procedures, particularly with regard to investor guidelines and strategies. The system for complaints processing was also restructured and allocated more staff.

● Insufficient liquidity.

In another case, several investors complained about the insufficient liquidity of the shares which a financial services provider had brokered for them. These shares were penny stocks, which could only be sold with hefty price markdowns due the lack of a liquid sales market. BaFin investigated whether the institution had given its customers enough warning about the insufficient liquidity of these financial instruments before they acquired the shares and whether the associated risk had been disclosed in an appropriate manner. This was not the case. Ultimately, BaFin revoked the institution's authorisation, as it had also violated a host of other statutory provisions in recent years, such as the notification and reporting requirements stipulated by the KWG and the obligation to submit its annual audit report by the correct deadline.

#### 6.4 Enquiries under the Freedom of Information Act

In the year under review, Frankfurt Administrative Court ruled on many requests to access information under the Freedom of Information Act (Informationsfreiheitsgesetz – IFG) which had been either wholly or partially rejected.

All the cases except one concerned the publication of company-related information with the objective of asserting compensation claims against the companies in question. The 7th Chamber of Frankfurt Administrative Court, which is responsible for the IFG, had in particular to decide on the scope of BaFin's confidentiality obligation as regulated in the supervisory laws and on the possible negative impact which access to the information would have on its supervisory activities. BaFin was of the opinion that the court's interpretation of the exclusion circumstances under the IFG, including the norms of confidentiality stipulated in special laws, was in part too narrow. BaFin appealed against those verdicts that granted permission.

In the meantime, in a case brought against the Federal Ministry of Finance regarding an administrative dispute over the publication of information under the IFG, Berlin Administrative Court confirmed the view held by BaFin that the publication of sensitive corporate information can destroy supervised companies' trust in BaFin's confidentiality and have a negative impact on its supervisory activities.<sup>56</sup> For in the event of such a loss of trust, BaFin would be in danger of only receiving such information from supervised companies as is prescribed by law, while the voluntary cooperation with BaFin, which is required for effective supervision, would largely come to an end. Banking and insurance associations had also highlighted this risk in several statements.

● Significant increase in new requests regarding banking and securities supervision.

At 407 (previous year: 53), the number of new requests under the IFG has risen considerably. A rise was observable particularly in

<sup>56</sup> Ref.: 2A 132.07.

the banking and securities sector. Whilst the sharp increase in the field of banking supervision was predominantly due to a large number of requests along the same lines, the number of requests in the field of securities supervision doubled.

As in previous years, BaFin had to refuse the majority of requests for information in 2008. In 354 cases, access to the information could not be permitted as there were grounds for an exclusion. Only in the field of securities supervision was BaFin able to make an at least partially positive decision in over half of cases and divulge the requested information to the applicants.

Table 31

**Enquiries under the IFG in 2008**

Supervisory area	Number	Request withdrawn	Access to information granted	Access to information granted in part	Access to information refused	Pending	Of which appeals submitted	Of which court action taken*
BA	339	1	1	5	330	2	5	6
VA	2	0	0	1	1	0	1	0
WA	64	1	18	16	23	6	13	4
Others	2	0	0	0	0	2	0	0
<b>Total</b>	<b>407</b>	<b>2</b>	<b>19</b>	<b>22</b>	<b>354</b>	<b>10</b>	<b>19</b>	<b>10</b>

\* Including appeal proceedings and procedures in the einstwiligen legal protection

## VIII About BaFin



### 1 Personnel and organisational structure

In the year under review, BaFin's Administrative Council approved 97 new posts for 2009. As at the end of 2008, BaFin employed 1,716 staff (2007: 1,693), 384 of whom were based in Frankfurt am Main and approximately 67% of whom overall (1,149) were civil servants (2007: 1,133).

Table 32

#### Staff as at 31 December 2008

Career path	Employed			Civil servants	Staff employed on a pay scale
	Total	Women	Men	Total	Total
Senior level	649	231	418	588	61
Upper level	599	284	315	497	102
Middle/lower level	468	312	156	64	404

● Women in managerial roles.

In 2008, around a quarter of managerial roles were once again held by women. In total, women made up about 50% of BaFin employees. 13 members of staff are on long-term secondment to European and international institutions and supervisory authorities.

Table 33

#### Recruitment in 2008

Career path	Total	Women	Men	Qualifications			
				Fully qualified lawyers	Economic scientists	Mathematicians/Statisticians	Others
Senior level	50	11	39	16	27	3	4
Upper level	16	8	8	4	11	1	
Middle level	19	13	6				
Trainee civil servants/Trainees	22	10	12				

BaFin recruited 107 new staff (including trainee civil servants, trainees and temporary staff), mainly fully qualified lawyers and graduates of higher education institutions.

- BaFin provides training in three careers.

BaFin is training one IT specialist, 27 office communication specialists and 1 media and information services specialist. In collaboration with the Bundesbank, it also offers trainee civil servants aiming at higher-level posts (currently 29) the option to prepare for their future work.

In 2008, 22 new trainees started their traineeships or career training at BaFin. At the end of the year under review, a total of 58 trainees and trainee civil servants were working for the supervisor.

### Organisation

In the year under review, BaFin combined the duties of organisational development and personnel development into a single section. As well as producing synergy effects, this restructuring ensures that both areas interlock and are managed in a uniform manner.

- Organisational and personnel development combined.

Personnel and organisational development pursue similar goals: personnel development equips each member of staff with the skills required to perform his duties successfully; organisational development deals with structure and process organisation and the appropriate structuring of teams, sections and departments.

- A tool for personnel development: further education and training.

In the year under review, 1,199 members of staff took part in professional development courses. This corresponds to 78% of all employees. In 2008, a total of 473 training events were held. As in the previous year, each employee participated in an average of five days of professional development in 2008.

- Performance-related pay for staff employed on a pay scale.

2008 saw BaFin introduce performance-related pay for staff employed on a pay scale. This consists of an individual performance-related sum which is paid as a bonus. Total funds corresponding to 1% of the previous year's remuneration for staff employed on a pay scale were available for this purpose. The individual performance of staff employed on a pay scale is determined either through regular appraisals or through agreements on personal objectives.

- BaFin provides family-friendly working conditions.

BaFin supports the compatibility of an employee's professional and family life within the scope of the legal and operational possibilities available. For instance, it offers personalised part-time arrangements, including during parental leave, flexible working hours and a set number of tele-working positions.

In August 2008, BaFin took over the operation of the company crèche at its Bonn site from the BMF and the Federal Statistical Office and have devised a new strategy for it in collaboration with parents. Up to 40 children from the age of three can be looked after for 45 hours each week. In future, the crèche will also be open to children from the age of two. BaFin intends to create similar childcare opportunities for its Frankfurt office.

BaFin provides three parent/child workrooms with a total of four workstations. These can be used for instance if the crèche has to close unexpectedly or a childminder cancels.



## 2 Cost and performance accounting

● Cost and performance accounting restructured.

BaFin revised its cost and performance accounting (Kosten- und Leistungsrechnung – KLR) procedure in 2008. Since the beginning of 2009, BaFin has not just used the KLR to calculate cost allocation but also to determine cost-covering charges and as an operational management tool.

The new KLR is based on the risk-oriented management of supervision already practised by BaFin. In other words, supervision must be set up in such a way that supervisory risks are identified early and can be processed according to their significance for the stability of the financial system. The KLR ties in with the system of risk classification and categorisation already in place at BaFin. It will provide information on the cost of particular supervisory activities and whether resources are being used appropriately for each supervisory risk.

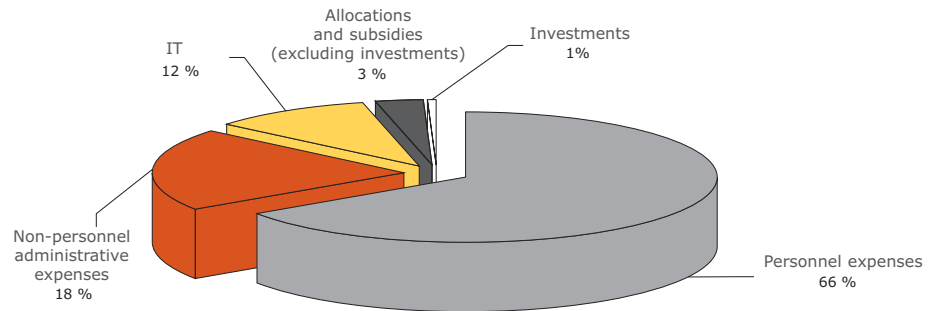
BaFin also intends to use the new KLR to manage its administration in an efficiency-oriented manner and is therefore basing it on the standard KLR used by the federal government. This reduces the number of products and makes it possible to compare the cost-efficiency of typical administrative activities across different authorities.

## 3 Budget

● 2008 budget: €122.9 million.

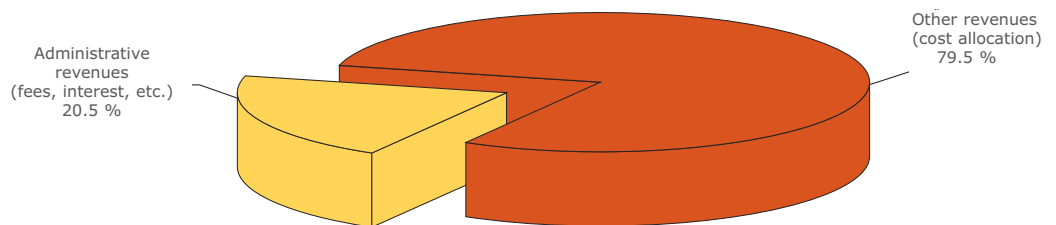
BaFin's budgetary plans provided for expenditures and revenues of around €122.9 million for 2008 (2007: €120.5 million). Personnel costs amounted to around 66% of the estimated expenditures, at €81.7 million (2007: €79.1 million), while non-personnel costs accounted for approximately 18%, at €21.8 million (2007: €24.5 million).

Figure 32  
**Expenditures (2008 budget)**



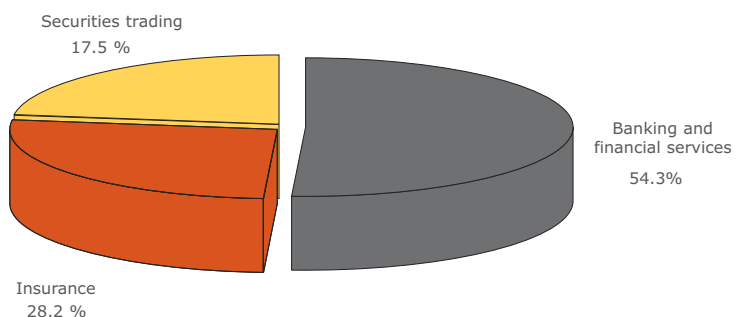
BaFin covered its expenditures in full from its own revenues, in particular from cost allocation payments (2008 estimate: approximately €97.7 million, 2007: €99.8 million), and fees and reimbursements (2008 estimate: approximately €23.7 million, 2007: €19 million) from the companies under its supervision. BaFin does not receive any subsidies from the federal budget.

Figure 33  
**Revenues (2008 budget)**



According to final calculations for the budget year 2007, the banking sector contributed 54.3%, the insurance sector 28.2% and the securities trading sector 17.5% of the overall total of approximately €84.1 million in cost allocation payments.

Figure 34  
**Cost allocations by supervisory area 2007**



- Revenues of €136.5 million, expenditures of €120.4 million.

BaFin based the calculation of prepayments for 2009 on this proportional distribution. The final cost distribution for 2008 will be calculated during 2009.

According to the 2008 annual accounts, which have not yet been adopted by the Administrative Council, spending by BaFin totalled approximately €120.4 million in 2008 (2007: €112.7 million). The supervisor generated revenues of around €136.5 million (2007: €128.2 million).

- Separate estimate for enforcement.

In the area of enforcement, separate revenues and expenditures of some €7.8 million were estimated in 2008 (2007: €7.8 million). Of this amount, approximately €6.3 million was allotted to the German Financial Reporting Enforcement Panel (2007: €6.5 million). In all, expenditures in the year under review stood at around €7.3 million compared to revenues of around €15.6 million (including cost allocation prepayments for 2009).

## 4 Public relations

- Financial crisis agitates media and public.

The financial crisis dominated the year under review, including in terms of enquiries from the media and the general public. Alongside the risk shield provided for the Hypo Real Estate Group, frequently asked questions concerned in particular the collapse of the US investment bank Lehman Brothers and its German subsidiary, the closure of the Icelandic Kaupthing Bank hf. and the questions of investor compensation arising from it. There was also considerable public interest in the takeover of Continental AG by the Schaeffler Group, the prohibition on short selling which BaFin imposed on eleven financial stocks and the payment freeze introduced by open-ended real estate funds.

- Brochure on securities trading.

In 2008, BaFin published a consumer brochure on securities trading,<sup>57</sup> which provides information on the process from the opening of a safekeeping account and the issuing of an order right through to the setting of prices. BaFin also gives advice to investors on how to avoid fraudsters, and highlights particularly high-risk operations such as trading in unknown shares or OTC securities. In addition, investors are informed of the situations in which BaFin is able to help them and when they should go straight to the police or public prosecutor.

- Forum for judges, public prosecutors and police officers.

Issues relating to securities trading, the prevention of money laundering and the prosecution of unauthorised financial operations were on the agenda of BaFin's fifth Forum on White-Collar Crime and the Capital Market. For instance, compliance officers from one bank gave a presentation on their day-to-day work and used cases of inside trading and market manipulation to illustrate how

<sup>57</sup> [www.bafin.de](http://www.bafin.de) » English Version » Publications » Brochures.

suspicious operations are detected within the bank and relayed to BaFin. The Federal Criminal Police Office (Bundeskriminalamt – BKA) and BaFin reported jointly on the widespread manipulation of OTC securities via market letters. As the manipulators often disappear off the scene shortly after driving up the prices of the securities concerned by means of reports in market letters, it is particularly important in these cases for the BKA, the prosecution authorities and BaFin to work together quickly and effectively. Participants were also brought up to date on case law, for instance regarding the assessment of collective investment models from the point of view of banking supervision.

The police, the prosecution authorities, the judiciary and the supervisor use the annual forum to strengthen and improve their cooperation.

Financial fairs and stock exchange open days.

In 2008, BaFin was represented at the Invest and IAM investor fairs as well as at open days on the Dresden, Hamburg, Munich and Frankfurt stock exchanges. Once again, a large number of visitors in the year under review made use of the events to gather information. At BaFin's stand, the most frequently asked questions from consumers included queries on current insolvency and compensation cases in the banking sector and on deposit guarantees. Financial services providers were primarily interested in the MiFID and the restrictions on short selling.

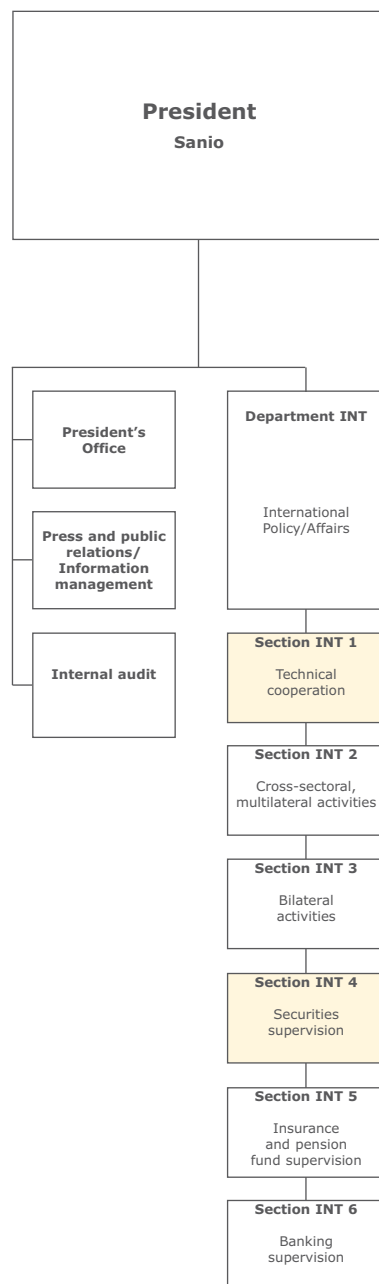


# Appendix



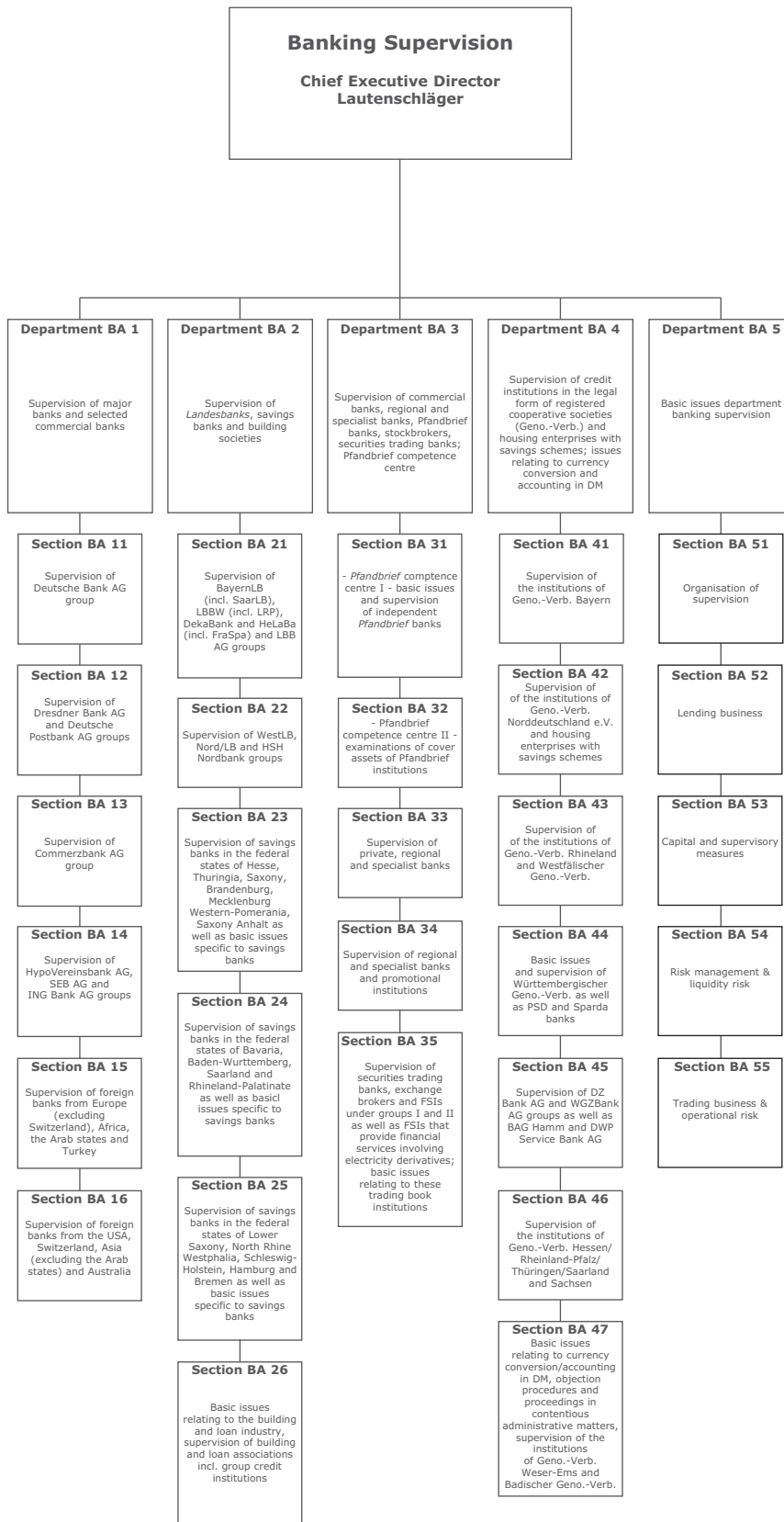


## Organisational overview

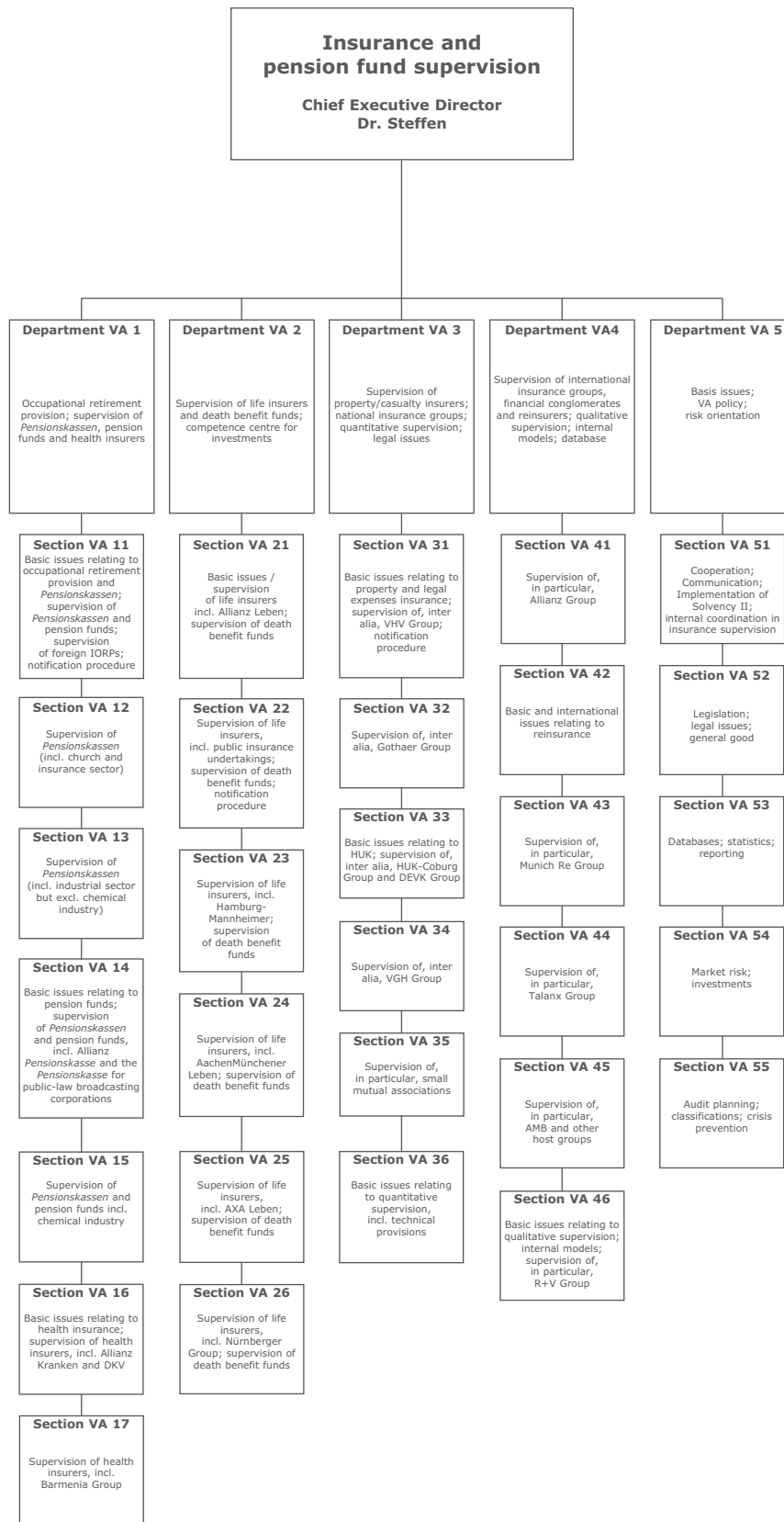


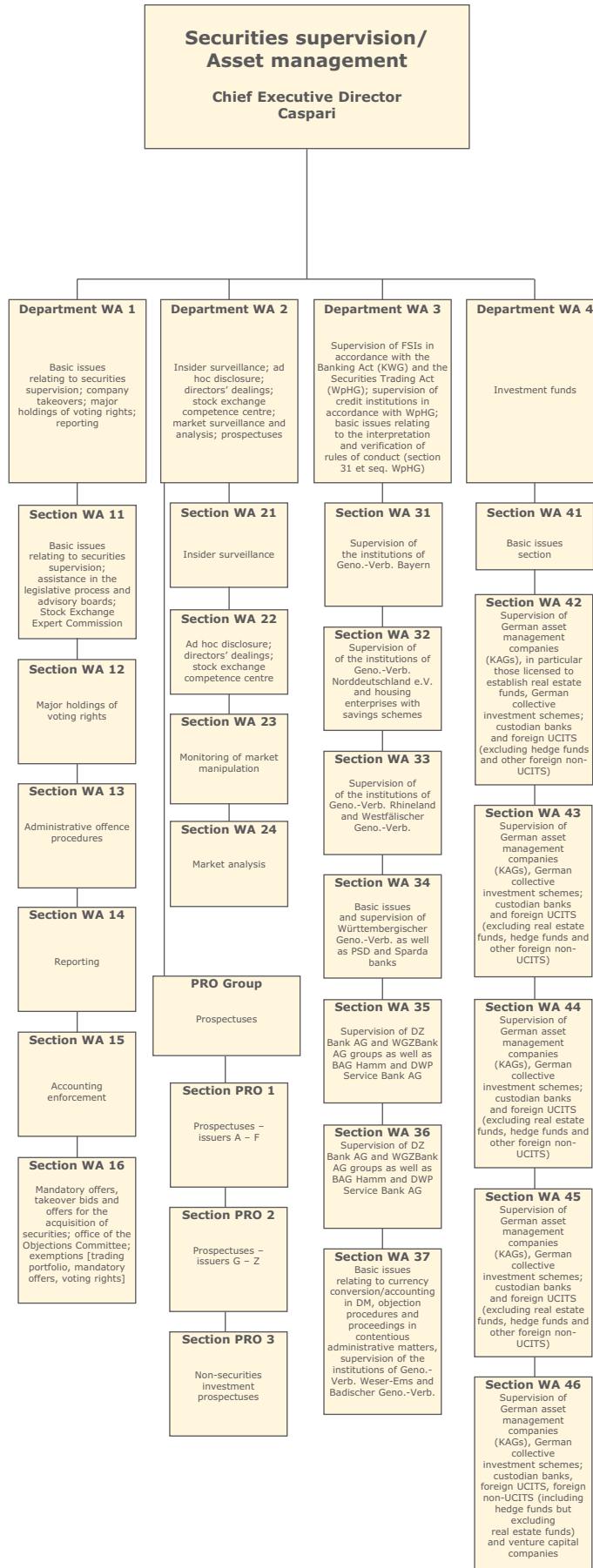
Bonn office

Frankfurt am Main office

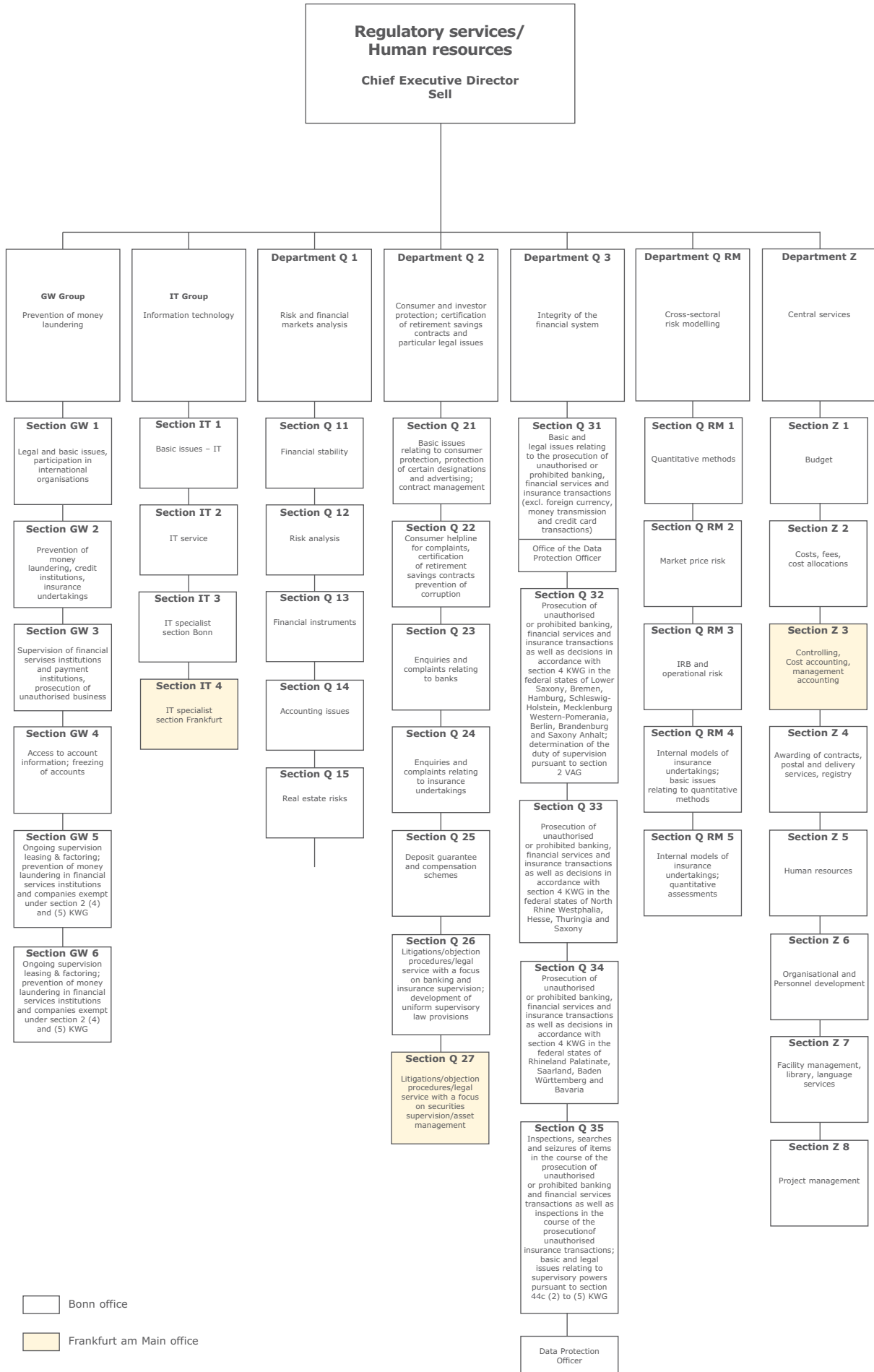








Bonn office  
 Frankfurt am Main office





# BaFin bodies

## 2.1 Members of the Administrative Council

### **Representatives of the Federal Ministries**

Asmussen, Jörg (BMF - Chairman)  
Dr. Wenzel, Rolf (BMF - Deputy Chairman)  
Schröder, Uwe (BMF)  
Dr. Kerkloh, Werner (BMF)  
Dr. Hardieck, Thomas (BMW)  
Schaefer, Erich (BMJ)

### **Representatives of the German Bundestag (Lower House of Parliament)**

Kalb, Bartholomäus (MdB)  
Bernhardt, Otto (MdB)  
Spiller, Jörg-Otto (MdB)  
Hauer, Nina (MdB)  
Thiele, Carl-Ludwig (MdB)

### **Representatives of credit institutions**

Fröhlich, Uwe  
Müller, Klaus-Peter  
Haasis, Heinrich  
Rasche, Henning  
Dr. Jaschinski, Siegfried

### **Representatives of insurance undertakings**

Hoenen, Rolf-Peter  
Dr. von Fürstenwerth, Jörg  
Dr. Oletzky, Torsten  
Dr. Caspers, Friedrich

### **Representatives of investment companies**

Dr. Mansfeld, Wolfgang

As at: May 2009

## 2.2 Members of the Advisory Board

### **Representatives of credit institutions**

Dr. Massenberg, Hans-Joachim  
Dr. Schackmann-Fallis, Karl-Peter  
Hofmann, Gerhard P.  
Tolckmitt, Jens  
Boos, Karl-Heinz  
Zehnder, Andreas J.

### **Representatives of insurance undertakings**

Dr. Schareck, Bernhard  
Dr. Rupprecht, Gerhard  
Dr. von Bomhard, Nikolaus  
Dr. Winkler, Heiko

### **Representative of investment companies**

Päsler, Rüdiger H.

### **Representative of the Bundesbank**

Loeper, Erich

### **Representative of the Association of Private Health Insurers**

Schulte, Reinhold

### **Representatives of academic groups**

Prof. Dr. Hackethal, Andreas  
Prof. Dr. Wagner, Fred  
Prof. Dr. Schnabel, Isabel

### **Representative of the Task Force for Occupational Retirement Provision – aba –**

Schwind, Joachim

### **Representatives of consumer protection organisations**

Kühnlenz, Stephan (Stiftung Warentest)  
Prof. Dr. Hirsch, Günter (Ombudsman for insurance undertakings)  
Dr. Balzer, Christian (Arbitrator for the Customer Complaints department of RSGV)

### **Representative of the legal and business professions**

Wüstenbecker, Jens (AfW)

### **Representative of SME associations**

Dr. König, Peter (DVFA)

### **Representative of the trade unions**

Foullong, Uwe (ver.di)

### **Representation of industry**

Härter, Holger P. (Porsche AG)

As at: April 2009

## 2.3 Members of the Insurance Advisory Council

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Prof. Dr. Christian Armbrüster	Judge at the Kammergericht (Berlin Higher Regional Court) Freie Universität Berlin Faculty of Law
Dr. Alexander Barthel	German Confederation of Skilled Crafts
Prof. Dr. Dr. h.c. Jürgen Basedow	Max Planck Institute for Foreign and International Private Law, Hamburg
Beate-Kathrin Bextermöller	Stiftung Warentest Financial Services Department
Dr. Georg Bräuchle	Verband Deutscher Versicherungsmakler e.V. Marsh GmbH
Lars Gatschke	Verbraucherzentrale Bundesverband e.V. Financial Services Department
Norbert Heinen	Member of the Executive Board Deutsche Aktuarvereinigung e.V.
Michael H. Heinz	President of the Bundesverband Deutscher Versicherungskaufleute e.V.
Werner Hölzl	Auditor and tax consultant Member of the Executive Board of PricewaterhouseCoopers
Prof. Dr. Gottfried Koch	Universität Leipzig Faculty of Mathematics and Computer Science
Dr. Ursula Lipowsky	Member of the Executive Board of Swiss Re Germany
Dr. Torsten Oletzky	Chairman of the Board of Management of ERGO Insurance Group AG
Dr. Gerhard Rupprecht	Chairman of the Executive Board of Allianz Deutschland AG

Dr. Bernhard Schareck	President of the Gesamtverbandes der Deutschen Versicherungswirtschaft e.V. Member of the Executive Board of Wüstenrot & Württembergische AG Chairman of the Supervisory Board of Karlsruher HK AG Member of the Supervisory Board of Karlsruher Lebensversicherung AG (i.a.)
Prof. Dr. Wolfgang B. Schönemann	Universität Dortmund Chair in Private Law
Reinhold Schulte	Chairman of the Verband der privaten Krankenversicherung e.V. Chairman of the Executive Board of the SIGNAL IDUNA Group
Prof. Dr. Hans-Peter Schwintowski	Humboldt-Universität Berlin Faculty of Law Chairman of the Academic Advisory Committee of the Bund der Versicherten e.V.
Richard Sommer	ver.di-Bundesverwaltung Vereinte Dienstleistungsgewerkschaft Financial Services
Ilona Stumm	Thyssen Krupp Risk and Insurance Services GmbH
Elke Weidenbach	Specialist insurance consultant Verbraucherzentrale NRW e.V. Financial Services Group
Michael Wortberg e.V.	Verbraucherzentrale Rheinland-Pfalz Consultant in insurance law
Prof. Dr. Wolfram Wrabetz	Representative agent of Hesse Regional Government in insurance matters Member of the Helvetia Group Executive Board CEO of Helvetia Deutschland
Prof. Dr. Jochen Zimmermann	Universität Bremen Economics Department

As at: April 2009



## 2.4 Members of the Securities Council

Ministry of Economic Affairs, Baden-Württemberg

State Ministry of Economic Affairs,  
Infrastructure, Transport and Technology, Bavaria

State Administration for Economic Affairs,  
Technology and Women, Berlin

Ministry of Economic Affairs, Brandenburg

Free Hanseatic City of Bremen  
Senator for Economic Affairs and Ports

Free Hanseatic City of Hamburg  
Department of Economic Affairs and Labour

Ministry of Economic Affairs, Transport and  
Urban and Regional Development, Hesse

Ministry of Economic Affairs, Mecklenburg-Western Pomerania

Ministry of Economic Affairs, Labour and Transport, Lower Saxony

Ministry of Finance, North Rhine-Westphalia

Ministry of Economic Affairs, Transport,  
Agriculture and Viniculture, Rhineland-Palatinate

Ministry of Economic Affairs and Labour, Saarland

State Ministry of Economic Affairs and Labour, Saxony

Ministry of Economic Affairs and Labour, Saxony-Anhalt

Ministry of Science, Economic Affairs and Transport,  
Schleswig-Holstein

Ministry of Finance, Thuringia

As at: April 2009



# Complaint statistics for individual undertakings

- 3.1 About these statistics
- 3.2 Life insurance
- 3.3 Health insurance
- 3.4 Motor insurance
- 3.5 General liability insurance
- 3.6 Accident insurance
- 3.7 Household insurance
- 3.8 Residential buildings insurance
- 3.9 Legal expenses insurance
- 3.10 Insurers based in the EEA

## 3.1 About these statistics

BaFin has been publishing complaint statistics broken down by insurance company and class in its annual report for some years. Its predecessor, the Federal Insurance Supervisory Office (Bundesaufsichtsamt für das Versicherungswesen – BAV), was ordered to include this information by the Berlin Higher Administrative Court in its ruling of 25 July 1995 (Ref.: OVG 8 B 16/94).

In order to provide an indicator as to the quality and volume of insurance business, the number of complaints fully processed by BaFin during 2008 is compared against the number of contracts in the respective insurance class as at 31 December 2007. Figures on existing business are reported by the insurance undertakings. The information on existing business puts those insurance undertakings going through a phase of strong expansion, which frequently include newly founded companies, at a disadvantage, because the new business generated during the year, on the basis of which complaints are made, is not accounted for in the complaint statistics. The informational value of these statistics is, therefore, limited with regard to the quality of individual undertakings.

In the case of collective insurance with regard to the existing business figure for life insurers, the figure specified relates to the number of insurance contracts. In health insurance, existing business is based on the number of natural persons who hold health insurance, rather than on the number of insured parties under each policy, which is usually higher. This key figure is still not entirely reliable.

The figures reported for the property and casualty sector relate to insured risks. If undertakings have concluded group policies with many insured persons, this will increase the figure for existing business. Owing to limited disclosure requirements (section 51 (4)

no. 1 sentence 4 RechVersV), the existing business figures can only be included for insurers whose gross premiums earned in 2007 exceeded €10 million in the respective insurance classes or types. With companies that did not meet this threshold in individual insurance classes, no information on existing business is given in the table (n.a.).

The statistics do not, however, include undertakings which, although operating within one of the classes listed, were not the subject of any complaints during the year under review.

No data are provided for companies from the European Economic Area, given that they are not accountable to BaFin. In order to present a more complete overview, the figures for the number of complaints have, however, been included.

### 3.2 Life insurance

Reg. no.	Name of insurance undertaking	No. of life insurance policies 2007	Complaints
1001	AACHENMÜNCHENER LEB.	5,444,373	176
1006	ALLIANZ LEBEN	10,338,178	374
1007	ALTE LEIPZIGER LEBEN	998,353	57
1035	ARAG LEBEN	361,012	15
1181	ASPECTA LEBEN	729,179	157
1303	ASSTEL LEBEN	368,137	43
1020	AXA LEBEN	2,016,708	130
1011	BARMENIA LEBEN	246,780	19
1012	BASLER LEBEN	180,256	12
1013	BAYER. BEAMTEN LEBEN	375,201	22
1015	BAYERN-VERS.	1,687,650	54
1132	CIV LEBEN	1,905,152	54
1122	CONCORDIA LEBEN	148,423	8
1021	CONDOR LEBEN	210,695	9
1078	CONTINENTALE LEBEN	649,153	28
1022	COSMOS LEBEN	1,345,227	51
1146	DBV-WINTERTHUR LEBEN	2,245,976	100
1023	DEBEKA LEBEN	3,220,679	27
1017	DELTA LLOYD LEBEN	630,088	46
1136	DEVK ALLG. LEBEN	661,197	22
1025	DEVK DT. EISENBAHN LV	804,895	8
1113	DIALOG LEBEN	234,878	1
1110	DIREKTE LEBEN	142,227	2
1180	DT. ÄRZTEVERSICHERUNG	206,495	15
1148	DT. LEBENSVERS.	289,092	2
1028	DT. RING LEBEN	970,669	55
1107	EUROPA LEBEN	439,758	4
1310	FAMILIENFÜRSORGE LV	293,773	10
1175	FAMILIENSCHUTZ LEBEN	152,821	12
1162	FORTIS DEUTSCHLAND	44,138	4
1063	GENERALI LV (ex.)	1,321,140	72
1108	GOTHAER LEBEN AG	1,251,939	79
1040	HAMBURGER LV AG	n.a.	2
1184	HAMB. MANNHEIMER LV	6,256,298	211
1312	HANNOVERSCHE LV AG	809,384	69
1114	HANSEMERKUR LEBEN	218,942	10
1192	HANSEMERKUR24 LV AG	1,181	0
1033	HDI-GERLING LEBEN	2,130,342	256
1158	HEIDELBERGER LV	479,198	30
1137	HELVETIA LEBEN	124,430	9
1055	HUK-COBURG LEBEN	733,486	40
1047	IDEAL LEBEN	543,364	14
1048	IDUNA VEREINIGTE LV	2,240,089	85
1097	INTER LEBEN	195,442	9
1330	INTER LEBENSVERS. AG	n.a.	5
1119	INTERRISK LEBENSVERS.	85,922	4
1128	ITZEHOER LEBEN	62,721	2
1045	KARLSRUHER LV AG	128,012	12

Reg. no.	Name of insurance undertaking	No. of life insurance policies 2007	Complaints
1130	KARSTADTQUELLE LV AG	1,296,786	24
1054	LANDESLEBENSHILFE	22,933	1
1062	LEBENSVERS. VON 1871	728,583	41
1112	LVM LEBEN	736,510	15
1109	MECKLENBURG. LEBEN	161,196	2
1064	MÜNCHEN. VEREIN LEBEN	143,007	10
1193	NECKERMANN LEBEN	65,896	1
1164	NEUE LEBEN LEBENSVERS	755,773	14
1131	NÜRNBERGER BEAMTEN LV	18,740	0
1147	NÜRNBG. LEBEN	3,068,798	238
1177	OECO CAPITAL LV AG	n.a.	1
1056	OEFF. LEBEN BERLIN	167,937	2
1115	ONTOS LEBEN	43,471	1
1194	PB LEBENSVERSICHERUNG	377,677	12
1145	PBV LEBEN	982,959	43
1123	PLUS LEBEN	34,075	1
1309	PROTEKTOR LV AG	195,781	32
1081	PROV. LEBEN HANNOVER	834,637	15
1083	PROV. NORTHWEST LEBEN	1,818,576	43
1082	PROV. RHEINLAND LEBEN	1,315,007	20
1085	R+V LEBEN, VAG	96,166	4
1141	R+V LEBENSVERS. AG	4,068,561	83
1018	RHEINLAND LEBEN	287,382	6
1090	SCHWEIZERISCHE LEBEN	1,190,986	71
1157	SKANDIA LEBEN	376,265	36
1153	SPARK.-VERS. SACHS. LEB	409,867	1
1104	STUTTGARTER LEBEN	450,526	43
1089	SÜDDEUTSCHE LV	n.a.	1
1091	SV SPARKASSENVERS.	1,692,978	39
1152	UELZENER LV-AG	n.a.	2
1092	UNIVERSA LEBEN	224,784	12
1093	VER. POSTVERS.	16	4
1314	VHV LEBENSVERSICHER.	9,974	1
1140	VICTORIA LEBEN	2,472,974	187
1139	VOLKSFÜRSORGE DT. LV	4,093,420	148
1099	VOLKSWOHL-BUND LEBEN	1,224,660	29
1151	VORSORGE LEBEN	85,256	6
1160	VPV LEBEN	1,185,887	55
1149	WGV-SCHWÄBISCHE LV AG	n.a.	1
1005	WÜRTT. LEBEN	1,688,552	107
1103	WWK LEBEN	982,908	80
1138	ZÜRICH DTSCH. HEROLD	3,583,740	245
1096	ZÜRICH LEBEN	243,231	2

### 3.3 Health insurance

Reg. no.	Name of insurance undertaking	No. of insured persons as at 31.12.2007	Complaints
4034	ALLIANZ PRIV.KV AG	2,416,819	208
4142	ALTE OLDENBURGER	129,843	10
4112	ARAG KRANKEN	320,190	25
4095	AXA KRANKEN	520,189	130
4042	BARMENIA KRANKEN	1,124,123	59
4134	BAYERISCHE BEAMTEN K	919,622	60
4127	BBV KRANKEN	15,322	1
4004	CENTRAL KRANKEN	1,641,992	94
4118	CONCORDIA KRANKEN	79,881	3
4001	CONTINENTALE KRANKEN	1,206,641	59
4101	DBV-WINTERTHUR KRANK.	873,851	53
4028	DEBEKA KRANKEN	3,401,574	94
4131	DEVK KRANKENVERS.-AG	168,368	2
4044	DKV AG	3,207,707	237
4013	DT. RING KRANKEN	611,691	25
4115	DÜSSELDORFER VERS. KR.	9,873	30
4121	ENVIVAS KV AG	n.a.	1
4089	EUROPA KRANKEN	210,633	13
4119	GOTHAER KV AG	491,030	39
4043	HALLESCHE KRANKEN	550,363	43
4144	HANSEMERKUR KRANKEN	1,027,007	38
4122	HANSEMERKUR S. KRANKEN	2,848,913	7
4117	HUK-COBURG KRANKEN	769,194	47
4031	INTER KRANKEN	388,557	32
4126	KARSTADTQUELLE KV AG	1,041,043	24
4011	LANDESKRANKENHILFE	419,296	32
4051	LIGA KRANKEN	4,171	1
4109	LVM KRANKEN	264,124	5
4123	MANNHEIMER KRANKEN	78,594	8
4037	MÜNCHEN. VEREIN KV	223,315	19
4125	NÜRNBG. KRANKEN	213,386	4
4143	PAX-FAMILIENF. KV AG	147,146	3
4135	PROVINZIAL KRANKEN	124,038	2
4116	R+V KRANKEN	408,000	2
4002	SIGNAL KRANKEN	1,984,238	99
4039	SÜDDEUTSCHE KRANKEN	515,662	23
4108	UNION KRANKENVERS.	970,296	20
4045	UNIVERSA KRANKEN	356,868	25
4105	VICTORIA KRANKEN	1.187,487	28
4139	WÜRTT. KRANKEN	118,755	3

### 3.4 Motor insurance

Reg. no.	Name of insurance undertaking	No. of insured risks as at 31.12.2007	Complaints
5342	AACHENMÜNCHENER VERS.	1,937,215	24
5135	ADAC AUTOVERSICHERUNG	n.a.	13
5498	ADAC-SCHUTZBRIEF VERS	n.a.	6
5312	ALLIANZ VERS.	14,911,925	204
5405	ALTE LEIPZIGER VERS.	415,179	9
5455	ARAG ALLG. VERS.	n.a.	10
5397	ASSTEL SACH	n.a.	14
5515	AXA VERS.	4,070,761	56
5593	BAD. ALLG. VERS.	n.a.	2
5316	BAD. GEMEINDE-VERS.	489,884	2
5317	BARMENIA ALLG. VERS.	408,673	1
5633	BASLER SECURITAS	486,026	10
5310	BAYER. BEAMTEN VERS.	263,911	7
5324	BAYER. VERS. VERB. AG	1,874,734	11
5098	BRUDERHILFE SACH. AG	384,238	9
5338	CONCORDIA VERS.	1,076,047	10
5339	CONDOR ALLG. VERS.	n.a.	1
5340	CONTINENTALE SACHVERS	368,997	5
5552	COSMOS VERS.	422,244	18
5529	D.A.S. VERS.	427,264	16
5343	DA DEUTSCHE ALLG. VER.	1,374,259	33
5311	DBV DT. BEAMTEN-VERS.	343,006	1
5037	DBV-WINTERTHUR	668,891	16
5549	DEBEKA ALLGEMEINE	663,499	7
5513	DEVK ALLG. VERS.	2,734,688	39
5055	DIRECT LINE	525,422	38
5084	DTSCH. INTERNET	n.a.	5
5541	EUROP ASSISTANCE	n.a.	2
5508	EUROPA SACHVERS.	383,544	16
5470	FAHRLEHRERVERS.	313,157	1
5024	FEUERSOZIETÄT	207,009	5
5505	GARANTA VERS.	1,028,397	24
5456	GENERALI VERS. AG (ex.)	1,621,596	39
5033	GERMAN ASSISTANCE	n.a.	1
5858	GOTHAER ALLGEMEINE AG	1,199,018	38
5585	GVV-PRIVATVERSICH.	243,487	3
5420	HAMB. MANNHEIMER SACH	505,623	6
5131	HANNOVERSCHE DIREKT	n.a.	8
5501	HANSEMERKUR ALLG.	n.a.	2
5085	HDI DIREKT	2,743,877	57
5512	HDI-GERLING FIRMEN	1,437,929	44
5096	HDI-GERLING INDUSTRIE	531,858	14
5384	HELVETIA VERS.	255,887	4
5086	HUK24 AG	1,255,290	42
5375	HUK-COBURG	6,880,986	63
5521	HUK-COBURG ALLG. VERS	5,297,903	50
5401	ITZEHOER VERSICHERUNG	787,781	9
5078	JANITOS VERSICHERUNG	275,230	14



Reg. no.	Name of insurance undertaking	No. of insured risks as at 31.12.2007	Complaints
5562	KARSTADTQUELLE VERS.	n.a.	2
5058	KRAVAG-ALLGEMEINE	1,057,162	15
5080	KRAVAG-LOGISTIC	668,428	16
5402	LVM SACH	4,552,237	26
5061	MANNHEIMER VERS.	191,917	2
5412	MECKLENBURG. VERS.	758,866	8
5414	MÜNCHEN. VEREIN ALLG.	n.a.	1
5426	NÜRNBG. ALLG.	290,654	2
5686	NÜRNBG. BEAMTEN ALLG.	323,615	4
5791	ONTOS VERS.	183,950	3
5519	OPTIMA VERS.	n.a.	1
5446	PROV. NORD BRANDKASSE	699,759	5
5095	PROV. RHEINLAND VERS.	1,203,742	16
5438	R+V ALLGEMEINE VERS.	3,615,810	36
5798	RHEINLAND VERS. AG	213,279	2
5051	S DIREKTVERSICHERUNG	n.a.	5
5773	SAARLAND FEUERVERS.	146,134	2
5690	SCHWARZMEER U. OSTSEE	n.a.	1
5448	SCHWEIZER NATION. VERS	n.a.	1
5125	SIGNAL IDUNA ALLG.	1,017,676	21
5781	SPARK.-VERS. SACHS. ALL	174,127	1
5036	SV SPARK. VERSICHER.	924,047	4
5463	UNIVERSA ALLG. VERS.	n.a.	1
5441	VEREINTE SPEZIAL VERS	594,279	27
5042	VERSICHERUNGSK. BAYERN	142,344	2
5400	VGH LAND. BRAND. HAN.	1,801,140	9
5862	VHV ALLGEMEINE VERS.	3,650,053	40
5472	VICTORIA VERS.	1,619,425	15
5473	VOLKSFÜRSORGE DT. SACH	1,264,090	26
5484	VOLKSWOHL-BUND SACH	114,031	1
5093	WESTF. PROV. VERS. AG	1,372,583	7
5525	WGV-SCHWÄBISCHE ALLG.	740,220	6
5479	WÜRTT. GEMEINDE-VERS.	964,710	2
5783	WÜRTT. VERS.	2,311,036	29
5476	WWK ALLGEMEINE VERS.	n.a.	5
5050	ZURICH VERS. AG	2,939,674	38

### 3.5 General liability insurance

Reg. no.	Name of insurance undertaking	No. of insured risks as at 31.12.2007	Complaints
5342	AACHENMÜNCHENER VERS.	1,234,192	31
5581	ADLER VERSICHERUNG AG	n.a.	1
5035	AGILA HAUSTIER AG	n.a.	1
5312	ALLIANZ VERS.	4,999,473	114
5405	ALTE LEIPZIGER VERS.	224,871	5
5455	ARAG ALLG. VERS.	21,233,559	17
5397	ASSTEL SACH	n.a.	4
5515	AXA VERS.	2,132,786	33
5316	BAD. GEMEINDE-VERS.	125,155	1
5317	BARMENIA ALLG. VERS.	n.a.	1
5633	BASLER SECURITAS	261,184	3
5310	BAYER. BEAMTEN VERS.	n.a.	1
5324	BAYER. VERS. VERB. AG	980,676	12
5098	BRUDERHILFE SACH. AG	223,965	1
5338	CONCORDIA VERS.	347,639	7
5340	CONTINENTALE SACHVERS	293,515	7
5552	COSMOS VERS.	n.a.	7
5529	D.A.S. VERS.	220,732	18
5771	DARAG DT. VERS. U. RÜCK	60,934	4
5311	DBV DT. BEAMTEN-VERS.	679,787	2
5037	DBV-WINTERTHUR	1,062,048	16
5549	DEBEKA ALLGEMEINE	1,101,065	7
5513	DEVK ALLG. VERS.	1,004,411	6
5344	DEVK DT. EISENB. SACH	612,010	3
5582	DT. ÄRZTE-VERS. ALLG.	n.a.	2
5350	DT. RING SACHVERS.	142,916	3
5508	EUROPA SACHVERS.	n.a.	1
5516	FAMILIENSCHUTZ VERS.	n.a.	4
5024	FEUERSOZIETÄT	127,646	6
5365	GEGENSEITIGKEIT VERS.	n.a.	1
5366	GEMEINN. HAFT GARTENB	n.a.	3
5456	GENERALI VERS. AG (ex.)	939,076	35
5858	GOTHAER ALLGEMEINE AG	1,364,488	65
5485	GRUNDEIGENTÜMER-VERS.	n.a.	2
5469	GVV-KOMMUNALVERS.	2,822	8
5585	GVV-PRIVATVERSICH.	n.a.	3
5374	HAFTPFLICHTK. DARMST.	681,529	7
5420	HAMB. MANNHEIMER SACH	574,814	22
5501	HANSEMERKUR ALLG.	n.a.	1
5085	HDI DIREKT	707,934	16
5512	HDI-GERLING FIRMEN	724,347	30
5096	HDI-GERLING INDUSTRIE	15,102	2
5384	HELVETIA VERS.	369,400	4
5086	HUK24 AG	n.a.	2
5375	HUK-COBURG	1,826,884	17
5521	HUK-COBURG ALLG. VERS	891,602	4
5546	INTER ALLG. VERS.	85,812	6

Reg. no.	Name of insurance undertaking	No. of insured risks as at 31.12.2007	Complaints
5057	INTERLLOYD VERS. AG	n.a.	1
5780	INTERRISK VERS.	n.a.	2
5401	ITZEHOER VERSICHERUNG	170,590	4
5562	KARSTADTQUELLE VERS.	n.a.	2
5402	LVM SACH	1,099,763	13
5061	MANNHEIMER VERS.	145,002	5
5412	MECKLENBURG. VERS.	263,745	6
5334	MEDIENVERS. KARLSRUHE	n.a.	3
5426	NÜRNBG. ALLG.	312,969	14
5686	NÜRNBG. BEAMTEN ALLG.	n.a.	2
5015	NV-VERSICHERUNGEN	n.a.	1
5786	OKV - OSTDT. KOMMUNAL	n.a.	3
5519	OPTIMA VERS.	n.a.	1
5446	PROV. NORD BRANDKASSE	388,723	3
5095	PROV. RHEINLAND VERS.	840,104	23
5438	R+v ALLGEMEINE VERS.	1,590,310	29
5798	RHEINLAND VERS. AG	135,420	8
5121	RHION VERSICHERUNG	n.a.	3
5773	SAARLAND FEUERVERS.	84,616	2
5690	SCHWARZMEER U. OSTSEE	n.a.	1
5125	SIGNAL IDUNA ALLG.	577,404	17
5781	SPARK.-VERS. SACHS. ALL	n.a.	3
5036	SV SPARK. VERSICHER.	750,849	8
5459	UELZENER ALLG. VERS.	149,367	1
5463	UNIVERSA ALLG. VERS.	n.a.	1
5042	VERS. KAMMER BAYERN (KOMMUNALVERSICHERER)	16,652	5
5400	VGH LAND. BRAND. HAN.	699,461	7
5862	VHV ALLGEMEINE VERS.	813,065	12
5472	VICTORIA VERS.	1,116,453	34
5473	VOLKSFÜRSORGE DT. SACH	1,011,528	31
5484	VOLKSWOHL-BUND SACH	n.a.	2
5461	VPV ALLGEMEINE VERS.	n.a.	2
5082	WALDENBURGER VERS.	n.a.	1
5093	WESTF. PROV. VERS. AG	814,443	9
5525	WGV-SCHWÄBISCHE ALLG.	304,470	4
5479	WÜRTT. GEMEINDE-VERS.	260,043	3
5480	WÜRTT. U. BADISCHE	123,357	2
5783	WÜRTT. VERS.	1,221,518	29
5590	WÜRZBURGER VERSICHER.	n.a.	4
5476	WWK ALLGEMEINE VERS.	n.a.	2
5050	ZURICH VERS. AG	1,002.931	33

### 3.6 Accident insurance

Reg. no.	Name of insurance undertaking	No. of insured risks as at 31.12.2007	Complaints
5342	AACHENMÜNCHENER VERS.	1,511,227	35
5498	ADAC-SCHUTZBRIEF VERS	2,723,680	3
5312	ALLIANZ VERS.	5,397,478	99
5405	ALTE LEIPZIGER VERS.	88,008	1
5068	AMMERLÄNDER VERS.	6,042	1
5455	ARAG ALLG. VERS.	20,493,315	14
5397	ASSTEL SACH	30,467	2
5515	AXA VERS.	805,103	13
5316	BAD. GEMEINDE-VERS.	46,257	2
5792	BADEN-BADENER VERS.	283,246	11
5317	BARMENIA ALLG. VERS.	127,161	5
5633	BASLER SECURITAS	148,051	6
5310	BAYER. BEAMTEN VERS.	97,466	5
5324	BAYER. VERS. VERB. AG	612,268	5
5098	BRUDERHILFE SACH. AG	35,779	1
5040	CIC DEUTSCHLAND	n.a.	1
5790	CIV VERS.	176,840	11
5338	CONCORDIA VERS.	286,040	5
5339	CONDOR ALLG. VERS.	78,647	3
5340	CONTINENTALE SACHVERS	735,537	9
5552	COSMOS VERS.	193,811	2
5529	D.A.S. VERS.	264,707	29
5343	DA DEUTSCHE ALLG. VER.	52,301	1
5311	DBV DT. BEAMTEN-VERS.	205,284	1
5037	DBV-WINTERTHUR	273,575	7
5549	DEBEKA ALLGEMEINE	1,716,071	7
5513	DEVK ALLG. VERS.	698,070	4
5344	DEVK DT. EISENB. SACH	271,783	2
5350	DT. RING SACHVERS.	403,082	24
5516	FAMILIENSCHUTZ VERS.	294,459	10
5456	GENERALI VERS. AG (ex.)	1,570,951	24
5858	GOTHAER ALLG. VERS. AG	722,585	26
5485	GRUNDEIGENTÜMER-VERS.	13,073	1
5420	HAMB. MANNHEIMER SACH	2,048,515	87
5501	HANSEMERKUR ALLG.	82,022	3
5085	HDI DIREKT	206,899	2
5512	HDI-GERLING FIRMEN	488,272	5
5375	HUK-COBURG	1,050,701	4
5573	IDEAL VERS.	15,043	2
5546	INTER ALLG. VERS.	78,253	5
5057	INTERLLOYD VERS. AG	54,434	2
5780	INTERRISK VERS.	398,447	5
5401	ITZEHOER VERSICHERUNG	109,425	1
5562	KARSTADTQUELLE VERS.	330,374	5
5402	LVM SACH	875,521	8
5061	MANNHEIMER VERS.	76,566	2
5412	MECKLENBURG. VERS.	140,382	3
5414	MÜNCHEN. VEREIN ALLG.	41,703	2

<b>Reg. no.</b>	<b>Name of insurance undertaking</b>	<b>No. of insured risks as at 31.12.2007</b>	<b>Complaints</b>
5591	NEUE LEBEN UNFALL	715,408	1
5426	NÜRNBG. ALLG.	624,361	51
5686	NÜRNBG. BEAMTEN ALLG.	107,858	5
5015	NV-VERSICHERUNGEN	46,093	1
5787	OVAG - OSTDT. VERS.	4,542	1
5074	PB VERSICHERUNG	61,774	1
5446	PROV. NORD BRANDKASSE	330,550	5
5095	PROV. RHEINLAND VERS.	1,256,494	4
5583	PVAG POLIZEIVERS.	312,506	1
5438	R+V ALLGEMEINE VERS.	1,514,753	17
5798	RHEINLAND VERS. AG	89,082	4
5690	SCHWARZMEER U. OSTSEE	46,254	1
5125	SIGNAL IDUNA ALLG.	1,839,735	30
5781	SPARK.-VERS. SACHS. ALL	61,754	3
5586	STUTTGARTER VERS.	242,274	10
5036	SV SPARK. VERSICHER.	313,594	3
5459	UELZENER ALLG. VERS.	63,893	1
5511	VER. VERS. GES. DTSCHL.	128,042	5
5862	VHV ALLGEMEINE VERS.	287,992	4
5472	VICTORIA VERS.	952,760	49
5473	VOLKSFÜRSORGE DT. SACH	703,698	15
5484	VOLKSWOHL-BUND SACH	176,806	4
5461	VPV ALLGEMEINE VERS.	151,364	2
5093	WESTF. PROV. VERS. AG	1,058,930	10
5783	WÜRTT. VERS.	780,002	23
5590	WÜRZBURGER VERSICHER.	54,548	7
5476	WWK ALLGEMEINE VERS.	202,626	10
5050	ZÜRICH VERS. AG	2,500,077	24

### 3.7 Household insurance

Reg. no.	Name of insurance undertaking	No. of insured risks as at 31.12.2007	Complaints
5342	AACHENMÜNCHENER VERS.	878,726	31
5581	ADLER VERSICHERUNG AG	n.a.	1
5312	ALLIANZ VERS.	2,933,908	69
5405	ALTE LEIPZIGER VERS.	154,199	10
5068	AMMERLÄNDER VERS.	n.a.	1
5455	ARAG ALLG. VERS.	883,011	17
5397	ASSTEL SACH	n.a.	2
5515	AXA VERS.	983,560	16
5357	BAD. BEAMTENBANK	n.a.	1
5317	BARMENIA ALLG. VERS.	n.a.	2
5633	BASLER SECURITAS	227,968	3
5310	BAYER. BEAMTEN VERS.	n.a.	3
5324	BAYER. VERS. VERB. AG	537,928	4
5098	BRUDERHILFE SACH. AG	196,568	2
5338	CONCORDIA VERS.	218,618	4
5004	CONSTANTIA	n.a.	1
5340	CONTINENTALE SACHVERS	143,651	6
5552	COSMOS VERS.	n.a.	1
5529	D.A.S. VERS.	137,590	10
5343	DA DEUTSCHE ALLG. VER.	n.a.	2
5311	DBV DT. BEAMTEN-VERS.	210,678	1
5037	DBV-WINTERTHUR	305,718	1
5549	DEBEKA ALLGEMEINE	673,310	2
5513	DEVK ALLG. VERS.	810,834	10
5344	DEVK DT. EISENB. SACH	453,359	2
5129	DFV DEUTSCHE FAM. VERS	n.a.	1
5328	DOCURA VVAG	n.a.	1
5350	DT. RING SACHVERS.	203,125	3
5516	FAMILIENSCHUTZ VERS.	n.a.	2
5024	FEUERSOZIETÄT	n.a.	1
5456	GENERALI VERS. AG (ex.)	601,291	18
5858	GOTHAER ALLGEMEINE AG	772,786	45
5557	HÄGER VERS. VEREIN	n.a.	2
5420	HAMB. MANNHEIMER SACH	420,186	21
5501	HANSEMERKUR ALLG.	n.a.	2
5085	HDI DIREKT	367,597	8
5512	HDI-GERLING FIRMEN	334,525	7
5384	HELVETIA VERS.	275,671	2
5086	HUK24 AG	n.a.	3
5375	HUK-COBURG	1,253,882	6
5521	HUK-COBURG ALLG. VERS	532,118	3
5546	INTER ALLG. VERS.	n.a.	6
5057	INTERLLOYD VERS. AG	130,009	1
5780	INTERRISK VERS.	n.a.	2
5078	JANITOS VERSICHERUNG	n.a.	2
5562	KARSTADTQUELLE VERS.	n.a.	1
5404	LBN	n.a.	2
5402	LVM SACH	651,044	9
5061	MANNHEIMER VERS.	92,605	3

<b>Reg. no.</b>	<b>Name of insurance undertaking</b>	<b>No. of insured risks as at 31.12.2007</b>	<b>Complaints</b>
5412	MECKLENBURG. VERS.	164,076	9
5334	MEDIENVERS. KARLSRUHE	n.a.	1
5414	MÜNCHEN. VEREIN ALLG.	n.a.	1
5426	NÜRNBG. ALLG.	156,703	9
5015	NV-VERSICHERUNGEN	n.a.	1
5446	PROV. NORD BRANDKASSE	301,439	2
5095	PROV. RHEINLAND VERS.	547,774	15
5583	PVAG POLIZEIVERS.	n.a.	1
5438	R+V ALLGEMEINE VERS.	798,004	20
5798	RHEINLAND VERS. AG	109,967	4
5491	SCHLESWIGER VERS. V.	n.a.	3
5690	SCHWARZMEER U. OSTSEE	n.a.	1
5125	SIGNAL IDUNA ALLG.	359,547	11
5781	SPARK.-VERS. SACHS. ALL	n.a.	2
5036	SV SPARK. VERSICHER.	406,951	4
5463	UNIVERSA ALLG. VERS.	n.a.	1
5400	VGH LAND. BRAND. HAN.	480,273	1
5862	VHV ALLGEMEINE VERS.	270,928	2
5472	VICTORIA VERS.	693,991	27
5473	VOLKSFÜRSORGE DT. SACH	852,227	24
5484	VOLKSWOHL-BUND SACH	n.a.	3
5461	VPV ALLGEMEINE VERS.	181,494	2
5093	WESTF. PROV. VERS. AG	2,432,138	9
5479	WÜRTT. GEMEINDE-VERS.	n.a.	1
5783	WÜRTT. VERS.	815,502	20
5590	WÜRZBURGER VERSICHER.	n.a.	4
5476	WWK ALLGEMEINE VERS.	n.a.	3
5050	ZÜRICH VERS. AG	714,809	18

### 3.8 Residential buildings insurance

Reg. no.	Name of insurance undertaking	No. of insured risks as at 31.12.2007	Complaints
5342	AACHENMÜNCHENER VERS.	337,301	15
5312	ALLIANZ VERS.	2,091,797	53
5405	ALTE LEIPZIGER VERS.	139,985	7
5455	ARAG ALLG. VERS.	n.a.	3
5515	AXA VERS.	552,024	13
5317	BARMENIA ALLG. VERS.	n.a.	1
5633	BASLER SECURITAS	157,259	6
5319	BAYER. HAUSBESITZER	n.a.	1
5043	BAYER. L-BRAND. VERS. AG	2,532,750	11
5324	BAYER. VERS. VERB. AG	535,921	11
5098	BRUDERHILFE SACH. AG	n.a.	1
5338	CONCORDIA VERS.	176,086	5
5340	CONTINENTALE SACHVERS	69,038	3
5529	D.A.S. VERS.	57,803	4
5771	DARAG DT. VERS. U. RÜCK	20,481	1
5311	DBV DT. BEAMTEN-VERS.	100,430	1
5037	DBV-WINTERTHUR	116,143	8
5549	DEBEKA ALLGEMEINE	210,674	2
5513	DEVK ALLG. VERS.	299,626	6
5344	DEVK DT. EISENB. SACH	164,695	2
5350	DT. RING SACHVERS.	47,956	3
5508	EUROPA SACHVERS.	n.a.	1
5024	FEUERSOZIETÄT	86,673	5
5456	GENERALI VERS. AG (ex.)	342,234	20
5858	GOTHAER ALLGEMEINE AG	290,022	24
5485	GRUNDEIGENTÜMER-VERS.	62,742	7
5585	GVV-PRIVATVERSICH.	n.a.	1
5032	HAMB. FEUERKASSE	161,119	3
5420	HAMB. MANNHEIMER SACH	127,450	7
5085	HDI DIREKT	149,438	4
5512	HDI-GERLING FIRMEN	112,069	4
5384	HELVETIA VERS.	168,796	6
5375	HUK-COBURG	535,601	9
5057	INTERLLOYD VERS. AG	n.a.	2
5402	LVM SACH	434,150	12
5061	MANNHEIMER VERS.	52,543	2
5412	MECKLENBURG. VERS.	95,368	6
5014	NEUENDORFER BRAND-BAU	n.a.	3
5426	NÜRNBG. ALLG.	70,112	2
5686	NÜRNBG. BEAMTEN ALLG.	n.a.	1
5015	NV-VERSICHERUNGEN	n.a.	1
5446	PROV. NORD BRANDKASSE	325,703	7
5095	PROV. RHEINLAND VERS.	625,423	29
5438	R+V ALLGEMEINE VERS.	793,588	27
5798	RHEINLAND VERS. AG	74,831	10
5491	SCHLESWIGER VERS. V.	n.a.	1
5690	SCHWARZMEER U. OSTSEE	n.a.	1
5448	SCHWEIZER NATION. VERS	n.a.	2
5125	SIGNAL IDUNA ALLG.	136,243	8



<b>Reg. no.</b>	<b>Name of insurance undertaking</b>	<b>No. of insured risks as at 31.12.2007</b>	<b>Complaints</b>
5781	SPARK.-VERS. SACHS. ALL	n.a.	2
5036	SV SPARK. VERSICHER.	2,478,370	33
5042	VERSICHERUNGSK. BAYERN	n.a.	1
5400	VGH LAND. BRAND. HAN.	482,012	6
5862	VHV ALLGEMEINE VERS.	71,784	5
5472	VICTORIA VERS.	347,227	14
5473	VOLKSFÜRSORGE DT. SACH	212,476	2
5461	VPV ALLGEMEINE VERS.	61,921	2
5093	WESTF. PROV. VERS. AG	2,026,320	9
5525	WGV-SCHWÄBISCHE ALLG.	n.a.	5
5783	WÜRTT. VERS.	454,810	14
5476	WWK ALLGEMEINE VERS.	n.a.	1
5050	ZURICH VERS. AG	388,479	15

### 3.9 Legal expenses insurance

Reg. no.	Name of insurance undertaking	No. of insured risks as at 31.12.2007	Complaints
5826	ADAC-RECHTSSCHUTZ	2,687,338	7
5809	ADVO CARD RS	1,457,547	101
5312	ALLIANZ VERS.	2,601,671	101
5825	ALLRECHT RECHTSSCHUTZ	248,558	20
5405	ALTE LEIPZIGER VERS.	n.a.	17
5800	ARAG ALLG. RS	1,590,043	123
5455	ARAG ALLG. VERS.	n.a.	8
5801	AUXILIA RS	511,377	12
5838	BADISCHE RECHTSSCHUTZ	140,235	2
5310	BAYER. BEAMTEN VERS.	n.a.	4
5831	CONCORDIA RS	393,018	20
5340	CONTINENTALE SACHVERS	n.a.	3
5802	D.A.S. ALLG. RS	2,777,171	100
5529	D.A.S. VERS.	n.a.	4
5343	DA DEUTSCHE ALLG. VER.	n.a.	5
5037	DBV-WINTERTHUR	152,912	12
5549	DEBEKA ALLGEMEINE	333,888	3
5803	DEURAG DT. RS	583,235	37
5829	DEVK RECHTSSCHUTZ	1,005,472	16
5129	DFV DEUTSCHE FAM. VERS	n.a.	1
5834	DMB RECHTSSCHUTZ	741,066	14
5456	GENERALI VERS. AG (ex.)	n.a.	4
5858	GOTHAER ALLGEMEINE AG	n.a.	4
5828	HAMB. MANNHEIMER RS	438,208	27
5420	HAMB. MANNHEIMER SACH	n.a.	3
5085	HDI DIREKT	n.a.	1
5827	HDI-GERLING RECHT.	492,523	18
5086	HUK24 AG	n.a.	4
5818	HUK-COBURG RS	1,508,942	47
5401	ITZEHOER VERSICHERUNG	n.a.	4
5812	JURPARTNER RECHTSSCH.	n.a.	5
5815	LVM RECHTSSCHUTZ	688,260	5
5412	MECKLENBURG. VERS.	133,607	15
5334	MEDIENVERS. KARLSRUHE	n.a.	3
5805	NEUE RECHTSSCHUTZ	430,568	18
5813	OERAG RECHTSSCHUTZ	1,242,724	44
5095	PROV. RHEINLAND VERS.	n.a.	1
5438	R+V ALLGEMEINE VERS.	n.a.	6
5836	R+V RECHTSSCHUTZ	597,190	4
5806	RECHTSSCHUTZ UNION	411,609	12
5807	ROLAND RECHTSSCHUTZ	1,122,039	62
5459	UELZENER ALLG. VERS.	n.a.	1
5400	VGH LAND. BRAND. HAN.	170,759	2
5472	VICTORIA VERS.	n.a.	2
5473	VOLKSFÜRSORGE DT. SACH	n.a.	1
5525	WGV-SCHWÄBISCHE ALLG.	394,742	18
5783	WÜRTT. VERS.	644,104	25
5050	ZURICH VERS. AG	466,600	26

### 3.10 Insurers based in the EEA

Reg. no.	Short name of insurance undertaking	Complaints
5902	ACE EUROPEAN (GB)	6
9053	ADMIRAL INSURANCE (GB)	3
5595	AIG EUROPE S.A. (F)	14
7698	AIG LIFE (IRL)	1
1306	AIG LIFE NIEDER. (IRL)	2
5029	AIOI MOTOR (GB)	6
7644	ALLIANZ WORLDW. (IRL)	5
7671	ASPECTA ASSUR. (L)	2
7323	ASPIS PRONIA (GR)	2
7576	ASSURANT LIFE (GB)	1
7203	ATLANTICLUX (L)	38
1324	ATLANTICLUX LEBEN (L)	3
5064	ATRADIUS KREDIT (NL)	4
7300	AXA BELG. (B)	1
5090	AXA CORPORATE S. (F)	4
7760	BANK AUSTRIA (A)	2
1300	CANADA LIFE (IRL)	35
1182	CARDIF LEBEN (F)	9
5056	CARDIF VERS. (F)	16
7693	CIGNA EUROPE (B)	1
1189	CIGNA LIFE INS. (B)	3
7453	CLERICAL MED.INV. (GB)	35
5047	CNA INSURANCE (GB)	1
7724	CREDIT LIFE INT. (NL)	6
7985	CSS VERSICHERUNG (FL)	1
7614	DB VITA SA (L)	2
5048	DOMESTIC AND GEN. (GB)	7
7309	DONAU VERSICHERUNG (A)	2
1161	EQUITABLE LIFE (GB)	1
7477	ERIKA FÖRSÄKRING (S)	1
7641	EURO INSURANCE (IRL)	2
7668	EUROMAF (F)	1
5115	EUROMAF SA (F)	1
5053	FINANCIAL INSUR. (GB)	3
7814	FRIENDS PROVID. (GB)	3
7268	GENERALI VERS. AG (A)	1
7587	INTERN. INSU. COR. (NL)	10
7284	INTERNATIONAL TR. (GB)	1
7031	LEGAL/GENERAL ASS (GB)	1
9031	LIBERTY EURO. (IRL/E)	23
5028	LIBERTY MUTUAL IN (GB)	1
7899	LIGHTHOUSE LIFE (GBZ)	4
7007	LLOYD'S OF LONDON (GB)	2
5592	LLOYD'S VERS. (GB)	3
7504	LONDON GEN. LIFE (GB)	1
7370	LONDON GENERAL (GB)	1
7236	LUXSTAR S.A. (L)	1
7828	MASSMUTUAL (L)	2
5636	MONDIAL ASSIST. (CH)	13

<b>Reg. no.</b>	<b>Short name of insurance undertaking</b>	<b>Complaints</b>
7579	NEMIAN LIFE & P. (L)	3
1185	PHOENIX METROLIFE (GR)	1
7723	PRISMALIFE AG (FL)	34
7215	PRUDENTIAL/SALI (IRL)	1
1317	R+V LUXEMB. LV (L)	33
7415	R+V LUXEMBOURG L (L)	10
7192	REASSURANTIE MAAT (NL)	2
7730	RIMAXX (NL)	13
7727	ROYAL LONDON (GB)	1
9064	STANDARD L. ASS. (GB)	1
1320	STANDARD LIFE (GB)	16
1174	STANDARD LIFE (GB)	2
7763	STONEBRIDGE (GB)	3
7518	SUN LIFE ASS. SOC. (GB)	1
9000	SWISSLIFE ASS. (F)	3
7289	UNUM LIMITED (GB)	1
1311	VDV LEBEN INT. (GR)	2
7456	VDV LEBEN INTERN. (GR)	20
7643	VIENNA-LIFE (FL)	3
7483	VORSORGE LUXEMB. (L)	16
7251	WIENER STÄDT. VERS. (A)	1
5088	XL INSURANCE (GB)	1
7929	ZURICH INSURANCE (IRL)	2

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## Abbreviations

<b>A</b>	<b>ABS</b>	Asset-backed securities	
	<b>AG</b>	Aktiengesellschaft (German public limited company) / Amtsgericht (Local Court)	
	<b>AIG</b>	American International Group	
	<b>AktG</b>	Aktiengesetz (Stock Corporation Act)	
	<b>ALM</b>	Asset liability management	
	<b>AltZertG</b>	Altersvorsorgeverträge-Zertifizierungsgesetz (Act Governing the Certification of Contracts for Private Old-Age Provision)	
	<b>AMA</b>	Advanced measurement approaches	
	<b>AnIV</b>	Anlageverordnung (Investment Ordinance)	
	<b>AnSVG</b>	Anlegerschutzverbesserungsgesetz (Act on the Improvement of Investor Protection)	
	<b>AntKIV</b>	Anteilklassenverordnung (Unit Class Ordinance)	
	<b>AnzV</b>	Anzeigenverordnung (Reports Ordinance)	
	<b>approx.</b>	Approximately	
	<b>AO</b>	Abgabenordnung (Tax Code)	
	<b>Art.</b>	Article	
	<b>AuslInvestmG</b>	Auslandinvestment-Gesetz (Foreign Investment Act)	
	<b>B</b>	<b>B</b>	Branch
		<b>BA</b>	Bankenaufsicht (banking supervision)
		<b>BaFin</b>	Bundesanstalt für Finanzdienstleistungsaufsicht (Federal Financial Supervisory Authority)
		<b>BAG</b>	Bundesarbeitsgericht (Federal Labour Court)
<b>BAKred</b>		Bundesaufsichtsamt für das Kreditwesen (former Federal Banking Supervisory Office)	
<b>BAV</b>		Bundesaufsichtsamt für das Versicherungswesen (former Federal Insurance Supervisory Office)	
<b>BAWe</b>		Bundesaufsichtsamt für den Wertpapierhandel (former Federal Securities Supervisory Office)	
<b>BCBS</b>		Basel Committee on Banking Supervision	
<b>BelWertV</b>		Beleihungswertermittlungsverordnung (Mortgage Lending Valuation Ordinance)	
<b>BerVersV</b>		Verordnung über die Berichterstattung von Versicherungsunternehmen (Ordinance on Reporting by Insurance Undertakings)	
<b>BGB</b>		Bürgerliches Gesetzbuch (Civil Code)	
<b>BGBI.</b>		Bundesgesetzblatt (Federal Law Gazette)	
<b>BGH</b>		Bundesgerichtshof (German Federal Court of Justice)	
<b>bil.</b>		Billion	
<b>BilKoG</b>		Bilanzkontrollgesetz (Accounting Enforcement Act)	
<b>BIS</b>		Bank for International Settlements	
<b>BIZ</b>		Bank für Internationalen Zahlungsausgleich (Bank for International Settlements)	

<b>BKA</b>	Bundeskriminalamt (Federal Criminal Police Office)
<b>BMF</b>	Bundesministerium der Finanzen (Federal Ministry of Finance)
<b>BörsG</b>	Börsengesetz (Exchange Act)
<b>BRE</b>	Beitragsrückerstattung (bonuses and rebates)
<b>BSC</b>	Banking Supervision Committee
<b>BSpkV</b>	Bausparkassenverordnung (Building Societies Ordinance)
<b>BVerfG</b>	Bundesverfassungsgericht (Federal Constitutional Court)
<b>BVerwG</b>	Bundesverwaltungsgericht (Federal Administrative Court)
<b>BVI</b>	Bundesverband Investment und Asset Management (Federal Investment and Asset Management Association)
<b>BVR</b>	Bundesverband der Deutschen Volksbanken und Raiffeisenbanken (Central organisation of German cooperative banking groups)
<b>C</b>	
<b>C</b>	Circular
<b>CDS</b>	Credit default swap
<b>CEBS</b>	Committee of European Banking Supervisors
<b>CEIOPS</b>	Committee of European Insurance and Occupational Pensions Supervisors
<b>CESR</b>	Committee of European Securities Regulators
<b>cf.</b>	Compare
<b>CFD</b>	Contracts for difference
<b>CGAP</b>	Consultative Group to Assist the Poor
<b>CI</b>	Credit institution
<b>CMBS</b>	Commercial mortgage-backed securities
<b>COREP</b>	Common solvency ratio reporting
<b>CRD</b>	Capital Requirements Directive
<b>CRSA</b>	Credit risk standardised approach
<b>D</b>	
<b>D</b>	Directive
<b>DAV</b>	Deutsche Aktuarvereinigung (German Actuarial Society)
<b>DAX</b>	Deutscher Aktienindex (blue chip index listing the 30 major German companies)
<b>DeckRV</b>	Deckungsrückstellungsverordnung (Mathematical Provisions Ordinance)
<b>DerivateV</b>	Derivateverordnung (Derivatives Ordinance)
<b>DL</b>	Dienstleistungsverkehr (provision of services)
<b>DSGV</b>	Deutscher Sparkassen- und Giroverband (German Savings Bank Association)
<b>E</b>	
<b>EAEG</b>	Einlagensicherungs- und Anlegerentschädigungsgesetz (Deposit Guarantee and Investor Compensation Act)
<b>EBK</b>	Eidgenössische Bankkommission (Swiss Federal Banking Commission)
<b>ECB</b>	European Central Bank
<b>ECJ</b>	European Court of Justice



<b>ECOFIN</b>	Economic and Financial Council
<b>EdB</b>	Entschädigungseinrichtung deutscher Banken GmbH (Compensatory Fund of German Banks)
<b>EdW</b>	Entschädigungseinrichtung der Wertpapierhandelsunternehmen (Compensation Fund of Securities Trading Companies)
<b>EEA</b>	European Economic Area
<b>EEC</b>	European Economic Community
<b>EEU</b>	European Economic Union
<b>EEX</b>	European Energy Exchange
<b>EFRAG</b>	European Financial Reporting Advisory Group
<b>e.g.</b>	For example
<b>EG</b>	Einführungsgesetz (Introductory Act)
<b>EMBI</b>	Emerging Markets Bond Index
<b>ERGEG</b>	Energy Regulators' Group for Electricity and Gas
<b>EAEG</b>	Einlagensicherungs- und Anlegerentschädigungsgesetz (Deposit Guarantee and Investor Compensation Act)
<b>ESCB</b>	European System of Central Banks
<b>etc.</b>	Et cetera
<b>EU</b>	European Union
<b>e.V.</b>	eingetragener Verein (registered society)
<b>F</b>	
<b>FATF</b>	Financial Action Task Force on Money Laundering
<b>f.</b>	And the following (page, line, etc.)
<b>ff.</b>	And the following (pages, lines, etc.)
<b>FinDAG</b>	Gesetz über die Bundesanstalt für Finanzdienstleistungsaufsicht (Act Establishing the Federal Financial Supervisory Authority)
<b>FinDAGKostV</b>	Verordnung über die Erhebung von Gebühren und die Umlegung von Kosten nach dem Finanzdienstleistungsaufsichtsgesetz (Ordinance on the Imposition of Fees and Allocation of Costs pursuant to the FinDAG)
<b>FinREP</b>	Financial Reporting
<b>FinReq</b>	Financial Requirements Expert Group
<b>FinRVV</b>	Finanzrückversicherungs-Verordnung (Finite Reinsurance Ordinance)
<b>FkSolv</b>	Finanzkonglomerate-Solvabilitäts-Verordnung (Financial Conglomerates Solvency Regulation)
<b>FLV</b>	Fondsgebundene Lebensversicherungen (fund-linked life insurance)
<b>FMFG</b>	Finanzmarktförderungsgesetz (Financial Market Promotion Act)
<b>FREP</b>	Financial Reporting Enforcement Panel
<b>FRUG</b>	Finanzmarktrichtlinie-Umsetzungsgesetz (Act Implementing the Markets in Financial Instruments Directive)

	<b>FSA</b>	Financial Services Authority
	<b>FSB</b>	Financial Stability Board
	<b>FSF</b>	Financial Stability Forum
	<b>FSI</b>	Financial Stability Institute
	<b>FY</b>	Financial year
<b>G</b>	<b>GAAP</b>	Generally Accepted Accounting Principles
	<b>GBC</b>	General Business Conditions
	<b>GbR</b>	Gesellschaft bürgerlichen Rechts (civil-law partnership)
	<b>GDP</b>	Gross domestic product
	<b>GDV</b>	Gesamtverband der deutschen Versicherungswirtschaft e.V. (German Insurance Association)
	<b>GG</b>	Grundgesetz (Basic Law)
	<b>GKV</b>	Gesetzliche Krankenversicherung (Statutory health insurance)
	<b>GKV-WSG</b>	Gesetzliche Krankenversicherung- Wettbewerbsstärkungsgesetz (Act on the Strengthening of Competition in Statutory Health Insurance)
	<b>GmbH</b>	Gesellschaft mit beschränkter Haftung (German private limited company)
	<b>GroMiKV</b>	Großkredit- und Millionenkreditverordnung (Ordinance governing Large Exposures and Loans of €1.5 million or more)
	<b>GTCI</b>	General Terms and Conditions of Insurance
	<b>GwG</b>	Geldwäschegesetz (Money Laundering Act)
<b>H</b>	<b>HessVGH</b>	Hessischer Verwaltungsgerichtshof (Hesse Administrative High Court)
	<b>HGB</b>	Handelsgesetzbuch (Commercial Code)
	<b>HRE</b>	Hypo Real Estate
	<b>HY</b>	Half-year
<b>I</b>	<b>i.a.</b>	inter alia
	<b>IAIS</b>	International Association of Insurance Supervisors
	<b>IAS</b>	International Accounting Standards
	<b>IASB</b>	International Accounting Standards Board
	<b>ICS</b>	Internal Control System
	<b>IdW</b>	Institut der Wirtschaftsprüfer (Institute of German Certified Public Accountants)
	<b>IFG</b>	Informationsfreiheitsgesetz des Bundes (Federal Freedom of Information Act)
	<b>IFRS</b>	International Financial Reporting Standards
	<b>IFSC</b>	Integrated Financial Supervisors Conference
	<b>IGSC</b>	Insurance Groups Supervision Committee
	<b>IGSRR</b>	Internal Governance, Supervisory Review and Reporting Expert Group
	<b>IIMG</b>	Inter-Institutional Monitoring Group
	<b>IKB</b>	IKB Deutsche Industriebank AG
	<b>IMF</b>	International Monetary Fund
	<b>IMWG</b>	Internal Models Working Group

	<b>incl.</b>	Including
	<b>Int. Mod</b>	Internal Model Expert Group
	<b>InvÄndG</b>	Investmentänderungsgesetz (Act Amending the German Investment Act)
	<b>Inv Prüfbv</b>	Investmentprüfberichtsverordnung (Investment Audit Report Ordinance)
	<b>InvG</b>	Investmentgesetz (Investment Act)
	<b>IOPS</b>	International Organization of Pension Supervisors
	<b>IOSCO</b>	International Organization of Securities Commissions
	<b>IRBA</b>	Internal ratings-based approach
	<b>IRC</b>	Incremental risk charge
	<b>ISA</b>	International Standards on Auditing
	<b>IT</b>	Information technology
	<b>IU</b>	Insurance undertaking
	<b>IWCFC</b>	Interim Working Committee on Financial Conglomerates
<b>J</b>	<b>JFCF</b>	Joint Committee on Financial Conglomerates
<b>K</b>	<b>KAG</b>	Kapitalanlagegesellschaft (asset management company)
	<b>KAGG</b>	Gesetz über Kapitalanlagegesellschaften (Asset Management Companies Act)
	<b>KaIV</b>	Kalkulationsverordnung (Calculation Ordinance)
	<b>KfW</b>	Kreditanstalt für Wiederaufbau (Reconstruction Loan Company)
	<b>KG</b>	Kommanditgesellschaft (German limited partnership)
	<b>KH-Versicherung</b>	Kraftfahrzeug-Haftpflichtversicherung (motor third party liability insurance)
	<b>KLR</b>	Kosten- und Leistungsrechnung (cost and performance accounting)
	<b>KSP</b>	Kreditsonderprüfungen (special lending-related audits)
	<b>KWG</b>	Gesetz über das Kreditwesen (Banking Act)
<b>L</b>	<b>LB</b>	Landesbank
	<b>LBS</b>	Landesbausparkasse (federal state building society)
	<b>LG</b>	Landgericht (Regional Court)
	<b>LiqV</b>	Liquiditätsverordnung (Liquidity Ordinance)
	<b>LI</b>	Life insurance
	<b>LIU</b>	Life insurance undertaking
	<b>LKA</b>	Landeskriminalamt (Regional Criminal Police Office)
<b>M</b>	<b>MaK</b>	Mindestanforderungen an das Kreditgeschäft (Minimum requirements for the credit business of credit institutions)
	<b>MaRisk</b>	Mindestanforderung an das Risikomanagement (Minimum requirements for risk management)

	<b>MaRiskVA</b>	Mindestanforderung an das Risikomanagement von Versicherern (Minimum requirements for risk management for insurers)
	<b>MBS</b>	Mortgage-backed securities
	<b>MCR</b>	Minimum capital requirement
	<b>mil.</b>	Million
	<b>MiFID</b>	Markets in Financial Instruments Directive
	<b>MMoU</b>	Multilateral Memorandum/a of Understanding
	<b>MoU</b>	Memorandum/a of Understanding
	<b>MSCI</b>	Morgan Stanley Capital International
	<b>MTF</b>	Multilateral trading facility
	<b>MTN</b>	Medium-term notes
	<b>MVP</b>	Melde- und Veröffentlichungsplattform (Reporting and Publishing Platform)
<b>N</b>	<b>n.a.</b>	Not available
	<b>NCFM</b>	National Commission of Financial Markets
	<b>NPL</b>	Non-performing loans
	<b>No.</b>	Number
<b>O</b>	<b>OECD</b>	Organisation for Economic Cooperation and Development
	<b>OFC</b>	Offshore financial centre
	<b>OJ</b>	Official Journal
	<b>OLG</b>	Oberlandesgericht (Higher Regional Court)
	<b>OTC</b>	Over-the-counter
	<b>OVG</b>	Oberverwaltungsgericht (Higher Administrative Court)
	<b>OWiG</b>	Gesetz über Ordnungswidrigkeiten (Act on Administrative Offences)
<b>P</b>	<b>p.</b>	Page
	<b>p.a.</b>	per annum
	<b>PF</b>	Pension fund
	<b>PfandBG</b>	Pfandbriefgesetz (Pfandbrief Act)
	<b>PKV</b>	Private Krankenversicherung (private health insurance)
	<b>P&amp;L</b>	Profit and loss account
	<b>PrüfbV</b>	Prüfungsberichtsverordnung (Audit Report Ordinance)
<b>Q</b>	<b>QFCRA</b>	Qatar Financial Centre Regulatory Authority
	<b>QIS</b>	Quantitative impact studies
	<b>QRM</b>	Querschnitt Risikomodellierung (cross-sectoral risk monitoring)
<b>R</b>	<b>Ref.</b>	Reference
	<b>Ref. no.</b>	Reference number
	<b>REITS</b>	Real Estate Investment Trusts
	<b>RfB</b>	Rückstellung für Beitragsrückerstattung (provisions for bonuses and rebates)
	<b>RoRAC</b>	Return on risk-adjusted capital

<b>S</b>	<b>s.</b>	See
	<b>SCR</b>	Solvency capital requirement
	<b>SEC</b>	Securities and Exchange Commission
	<b>SGB</b>	Sozialgesetzbuch (Social Code)
	<b>SIV</b>	Structured investment vehicle
	<b>SCM</b>	Standard cost model
	<b>SME</b>	Small and medium-sized enterprises
	<b>SoFFin</b>	Sonderfonds Finanzmarktstabilisierung (Special Fund Financial Market Stabilisation)
	<b>SolBerV</b>	Solvabilitätsbereinigungs-Verordnung (Solvency Adjustment Ordinance)
	<b>SolvV</b>	Solvabilitätsverordnung (Solvency Ordinance)
	<b>SPV</b>	Special purpose vehicle
	<b>SRP</b>	Supervisory review process
	<b>STA</b>	Standardansatz (standard approach)
	<b>StPO</b>	Strafprozessordnung (Code of Criminal Procedure)
	<b>SWAP</b>	Securities watch applications
	<b>T</b>	<b>tr.</b>
<b>TUG</b>		Transparenzrichtlinie-Umsetzungsgesetz (Transparency Directive Implementation Act)
<b>U</b>	<b>UCITS</b>	Undertakings for the collective investment of transferable securities
	<b>UK</b>	United Kingdom
	<b>UStG</b>	Umsatzsteuergesetz (VAT Act)
<b>V</b>	<b>VA</b>	Versicherungsaufsicht (insurance supervision)
	<b>VaR</b>	Value at risk
	<b>VAG</b>	Versicherungsaufsichtsgesetz (Insurance Supervision Act)
	<b>VDAX</b>	VDAX volatility index
	<b>VerBaFin</b>	Veröffentlichungen der Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin publications)
	<b>VerkprospG</b>	Verkaufsprospektgesetz (Prospectus Act)
	<b>VermVerkProspV</b>	Vermögensanlagen-Verkaufsprospektverordnung (Investment Prospectus Ordinance)
	<b>VersR</b>	Versicherungsrecht (insurance law)
	<b>VG</b>	Verwaltungsgericht (Administrative Court)
	<b>VGH</b>	Verwaltungsgerichtshof (Administrative High Court)
	<b>VO</b>	Verordnung (ordinance/regulation)
	<b>VVG</b>	Versicherungsvertragsgesetz (Insurance Contract Act)
<b>W</b>	<b>WA</b>	Wertpapieraufsicht (securities supervision)
	<b>WkBG</b>	Wagniskapitalbeteiligungsgesetz (Venture Capital Investment Act)
	<b>WpDPV</b>	Wertpapierdienstleistungs-Prüfungsverordnung (Ordinance on the Examination of Investment Services Enterprises)

	<b>WpHG</b>	Wertpapierhandelsgesetz (Securities Trading Act)
	<b>WpHMV</b>	Wertpapierhandel-Meldeverordnung (Securities Trading Reporting Ordinance)
	<b>WpPG</b>	Wertpapierprospektgesetz (Securities Prospectus Act)
	<b>WpÜG</b>	Wertpapiererwerbs- und Übernahmegesetz (Securities Acquisition and Takeover Act)
<b>Z</b>	<b>ZAG</b>	Zahlungsdiensteaufsichtsgesetz (Payment Services Supervision Act)
	<b>ZKA</b>	Zentraler Kreditausschuss (Central Credit Committee)



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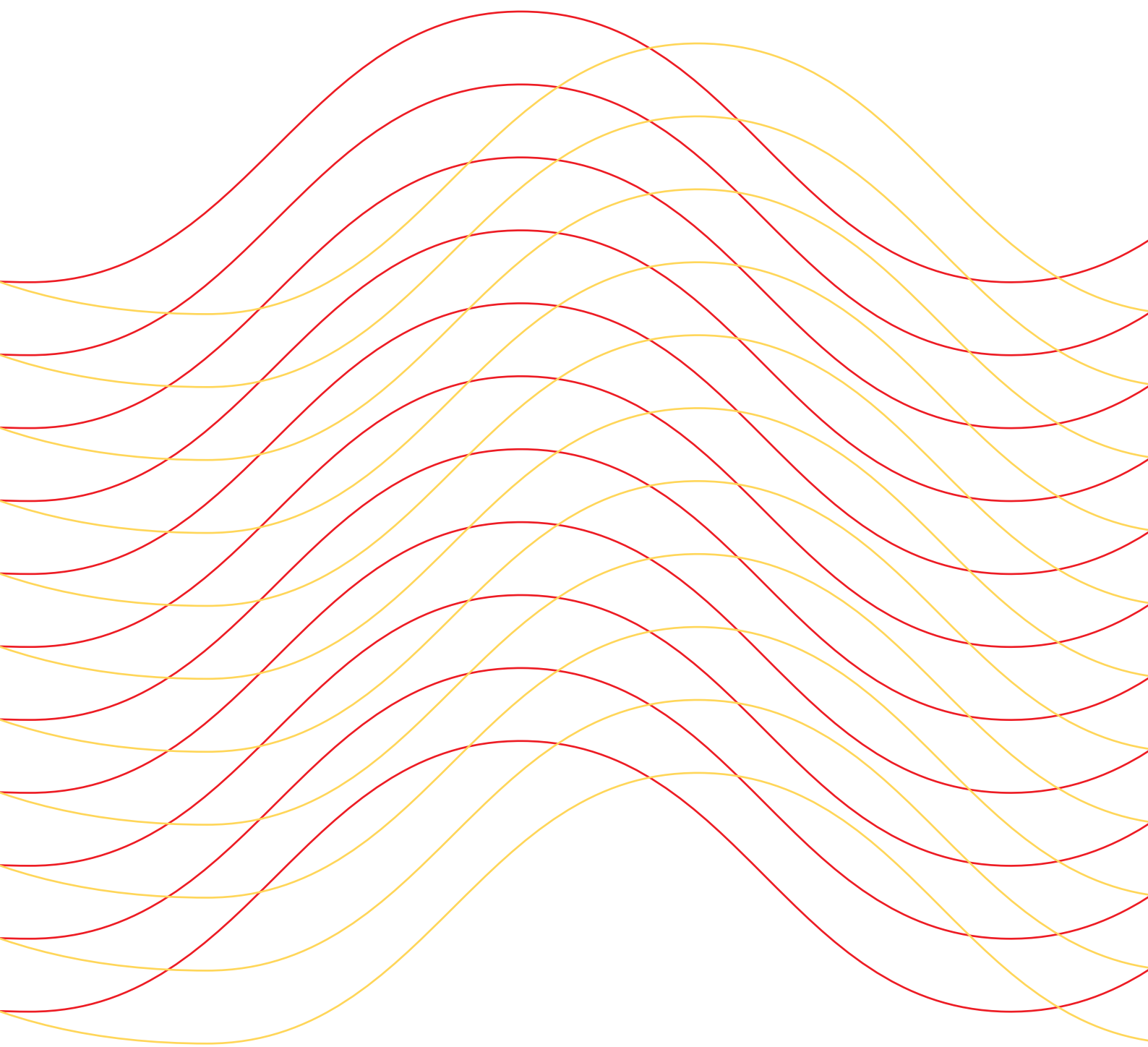
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