



The new Federal Financial Supervisory Authority (BaFin)

Following the adoption on 22 April 2002 of the Law on Integrated Financial Services Supervision (Gesetz über die integrierte Finanzaufsicht - FinDAG), the Federal Financial Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht - BaFin) was established on 1 May 2002. The functions of the former offices for banking supervision (Bundesaufsichtsamt für das Kreditwesen - BAKred), insurance supervision (Bundesaufsichtsamt für das Versicherungswesen - BAV) and securities supervision (Bundesaufsichtsamt für den Wertpapierhandel - BAWe) have been combined in a single state regulator that supervises banks, financial services institutions and insurance undertakings across the entire financial market and comprises all the key functions of consumer protection and solvency supervision. The new Federal Financial Supervisory Authority will make a valuable contribution to the stability of Germany as a financial centre and improve its competitiveness.

The BaFin is a federal institution governed by public law that belongs to the portfolio of the Federal Ministry of Finance and as such, has a legal personality. Its two offices are located in Bonn and Frankfurt/Main, where approximately 1,000 persons are employed. The BaFin supervises about 2,700 banks, 800 financial services institutions and over 700 insurance undertakings.

Reasons for establishing a single regulator for integrated financial services supervision

The decision to set up the BaFin was made basically in light of the fundamental changes on the financial markets which required a legislative response that would ensure the future stability of the German financial system.

The single regulator was set up mainly for the following reasons:

An increasing number of clients of banks, financial services institutions and insurance companies are demanding integrated financial products. The providers of such products have adapted themselves to these demands and developed cross-sectoral products and strategies. The former distinctions between banking and financial services on the one hand and insurance business on the other are gradually disappearing: Insurance companies have entered the traditional banking business by offering integrated financial services, for instance within the scope of asset management, whereas at the same time banks have developed new lines of products and with these, are now dealing in core businesses once exclusively reserved for insurers. Consequently, suppliers are competing for the same clients with similar or even identical products. Furthermore, competition is intensified by the use of electronic distribution channels on the internet and by the savings potential involved. The client, in turn, is mainly interested in the product, i.e. it is of minor importance to him whether it is offered by a bank or an insurance company.

As a result, there is a growing tendency among banks, financial services institutions and insurance undertakings to form cross-sectoral groups for whom it is easier to place broad product ranges effectively in the market. In the past, banks and insurance companies maintained only loose connections whereas today, powerful financial conglomerates have emerged in Germany which operate at a global level. Notable examples include the groups Allianz/Dresdner Bank and Münchner Rück/HypoVereinsbank, which in terms of market capitalisation rank among the world's largest financial conglomerates. The trend towards integrated bankassurance groups is expected to continue.

In view of these developments, the former separation of supervisory functions into the BAKred, BAV and BAWe has become obsolete: Over the last few years, a growing number of states have established modern integrated supervisory structures. Comprehensive powers and a full-scale overview of the market will enable the new German regulator to carry out supervision effectively and thus to contribute to the stability of Germany as a financial centre. This will help avoid imbalances in competition which can easily occur as a result of regulatory differences in a fragmented supervisory system.

The fact that the new German regulator is responsible for all market participants is also of major importance. Especially with regard to foreign companies this is an advantage that should not be underestimated, considering the fact that in the past they had to deal with several supervisory offices when trying to offer their products in Germany.

The foundation of a single regulator will also facilitate the exchange of information with supervisory authorities in other states. In addition, the voice of the new German regulator will carry more weight in international supervisory forums and as a result, German interests can be represented more effectively at an international level. This will help strengthen Germany as a financial centre. As regards supervision in Germany, the new organisational structure will result in synergies. The integration of the former supervisory offices in a single body enables them to use their know-how and experience more efficiently, especially with regard to the trend towards product convergence and the emergence of financial conglomerates. Moreover, there is no further need for coordination between individual supervisory offices, which in the past was often time consuming and caused considerable expenses. However, although financial services supervision has been organised in a single body this does not mean that existing sectoral differences between the banking and insurance businesses will be disregarded. These differences have led to the development of specific supervisory methods and rules for banks and insurance companies which have proved to be successful. Thus, when creating the new structure the legislator decided not to change the substantive laws underlying supervision, for instance the German Banking Act (Gesetz über das Kreditwesen - KWG), the Insurance Supervision Law (Versicherungsaufsichtsgesetz - VAG) and the German Securities Trading Act (Gesetz über den Wertpapierhandel - WpHG).

The structure of the BaFin takes account of the sectoral differences: Separate organisational units were created for banking supervision, insurance supervision and securities supervision/asset management. Cross-sectoral tasks necessitated by the developments in the financial markets are carried out by several cross-sectoral departments which are organisationally separated from the traditional supervisory functions. The tasks of these departments include the supervision of financial conglomerates, coordination of the work in international supervisory forums and the fight against money laundering across all sectors. The latter has been of particular importance ever since the terrorist attacks in New York.

The new Federal Financial Supervisory Authority, as a single regulator, is better able than any other supervisory structure to develop equal rules for equal risks and thus to ensure equality of regulatory treatment and a level playing field. In addition, the new structure of German supervision helps strengthen Germany's role as a financial centre and its ability to compete on an international scale.

The objectives of integrated financial services supervision in Germany

The BaFin has three main supervisory objectives: Its paramount aim is to ensure the functioning of the entire financial industry in Germany. From this objective, two others can be inferred: to safeguard the solvency of banks, financial services institutions and insurance undertakings - which in the past was mainly a task of the BAKred and the BAV - and to protect clients and investors.

The organisation of the BaFin and the functions of the supervisory directorates

Essentially, the BaFin comprises three supervisory directorates which now perform the supervisory tasks of the three formerly separate supervisory offices. They do not, however, deal with cross-sectoral issues; those have been assigned to three cross-sectoral departments. The directorates are each headed by a First Director.

The first directorate: Banking Supervision

The first directorate, Banking Supervision, has been assigned all regulatory powers in the framework of solvency-oriented supervision of banks. Banking supervision aims at securing the functioning of the banking industry in order to keep the economy stable, while at the same time it is intended to provide maximum protection for clients' capital deposited with banks. Banking supervision is essentially based on the German Banking Act (KWG) as well as on specific legislation such as the Mortgage Bank Act (Hypothekbankgesetz) and the Building Societies Act (Bausparkassengesetz). The Deutsche Bundesbank will continue to be involved in the ongoing supervision of banks in accordance with section 7 of the Banking Act.

The tasks of the directorate for Banking Supervision are manifold, given that banks have to meet many legal requirements before they are allowed to provide banking services. For example, they must comply with the capital adequacy requirements and have an appropriate organisational structure as well as at least two professionally qualified and reliable managers. The BaFin monitors compliance with these requirements to make sure that banking services are provided only by undertakings that are solvent and can be expected to manage the business properly. The persons employed in the directorate for Banking Supervision monitor banks on an ongoing basis in order to verify their compliance with the capital adequacy requirements and if they maintain sufficient liquid funds. As regards the important lending business of banks, the BaFin checks if banks comply with statutory risk limits (e.g. large exposure limits) and if their bad debt provisions are in line with their risk exposure.

Growing complexity of banking business compels banks to take suitable measures for the purpose of controlling and monitoring the manifold risks involved in such transactions. As a result, the focus of supervision is on the banks' internal risk controlling and management systems. Furthermore, in line with this risk-oriented supervisory approach the banking supervisor has to be regularly informed about the economic situation of the respective institution, its business strategies and lines of business, as well as its project pipeline, and must evaluate these projects from a banking supervisory point of view.

The main sources of information available to the banking supervisory staff include a multitude of notifications and, in particular, the audit reports of annual accounts prepared by auditors or audit associations. Moreover, exceptional audits provide the BaFin with a better insight into a bank's economic situation. If clients' deposits entrusted to the bank are at risk the BaFin may take measures

to avert these dangers, which may even go as far as withdrawing the authorisation to provide banking services. Moreover, the supervisory authority may dismiss unqualified managers. The directorate for Banking Supervision consists of four departments plus one group and comprises 31 sections.

The second directorate: Insurance Supervision

The second supervisory directorate is responsible for supervising insurance companies in accordance with the Insurance Supervision Law (VAG). The key objectives of insurance supervision consist in protecting the interests of the insured and in making sure that insurers are able to meet their future liabilities at all times.

Insurance companies are allowed to carry out insurance business only after obtaining an authorisation from the BaFin. Companies authorised to write insurance in Germany have to meet various requirements. Before granting the authorisation, the supervisor conducts a comprehensive legal and financial examination. For instance, the insurer is required to submit the operating plan as well as evidence of its own funds to the BaFin. Managers must furnish proof of their good repute and professional qualification. The BaFin monitors if insurance companies have set up sufficient provisions, have sufficient uncommitted funds and take out reinsurance to an appropriate degree to protect themselves against unexpected losses. Moreover, the insurance supervisory staff check if the annual accounts are drawn up correctly in accordance with applicable accounting standards and present a fair view of the insurer's financial situation. Finally, on-site inspections of insurance companies are carried out at regular intervals.

The Insurance Supervision Law provides the BaFin with various instruments to intervene in an insurer's operations for the purpose of preventing or eliminating irregularities or dangers. In the worst case, the authorisation may have to be withdrawn.

Insurance supervision is carried out by 6 departments which comprise a total of 33 sections.

The third directorate: Securities Supervision/Asset Management

The principal responsibility of the third directorate, Securities Supervision/Asset Management, consists in securing the functioning of German securities and derivatives markets in accordance with the Securities Trading Act (WpHG). In addition, the directorate has been assigned some of the duties of the former BAKred. Under the Securities Trading Act, taking advantage of inside knowledge and/or the unauthorised passing on of inside information is prohibited as this would undermine investors' confidence in fair and equal securities trading. The members of staff analyse trading patterns by means of securities trades reported to the BaFin in accordance with section 9 of the Securities Trading Act and evaluate them with regard to unusual price movements or turnover in order to be able to prosecute any cases of insider dealing they may discover. If indications of forbidden insider dealing are revealed the BaFin informs the public prosecutor. Insider offences are punishable by a fine or imprisonment of up to five years.

The reporting requirements stipulated in the Securities Trading Act play an important part in improving market transparency, given that both retail and professional investors require up-to-date and reliable information for their investment decisions. Thus, listed companies are obliged to publish immediately any new information that is likely to have a considerable effect on the stock market price (ad hoc disclosure). Moreover, owners of major holdings of voting rights in stock

corporations whose shares are admitted to official trading or the regulated market must inform the public of the percentage of securities they hold as soon as certain thresholds are exceeded or dropped below. The BaFin may punish violations against these reporting requirements by imposing an administrative fine. Last but not least, the BaFin acts as a depository for prospectuses.

When providing securities services to customers, credit institutions and financial services institutions must comply with particular rules of conduct that serve the protection of investors. Compliance with these rules is checked once every year by external auditors on behalf of the BaFin. Information about the particular terms and risks of the products on offer as well as the costs involved enables investors to make their own, qualified investment decisions. The enterprises must have an appropriate organisational structure and establish internal control mechanisms to avoid conflicts of interest within the institutions.

Corporate takeovers have been supervised in accordance with the new Securities Acquisition and Takeover Act (Wertpapiererwerbs- und Übernahmegesetz - WpÜG) since 1 January 2002. The BaFin makes sure that takeover proceedings are in line with the regulations and monitors the offerors' compliance with the publication requirements.

Before the BaFin was founded, Asset Management and its sections belonged to the BAKred. Their responsibilities consist in monitoring both investment companies and financial services institutions as well as the marketing activities of foreign investment companies in accordance with the Foreign Investment Act (Auslandsinvestment-Gesetz). Their tasks being closely related to securities supervision, they were integrated into the third directorate when the supervisory authority was reorganised.

The directorate for Securities Supervision/Asset Management is comprised of four departments, one of which includes a separate group. The total number of units in the directorate is 25.

Cross-sectoral departments

The traditional supervisory directorates have been supplemented by three cross-sectoral departments which deal with cross-sectoral issues. Close cooperation between the directorates and the cross-sectoral departments ensures that a balance is kept between sector-specific and cross-sectoral aspects of supervision.

The **first cross-sectoral department**, Financial Market/International Issues, deals with cross-sectoral issues concerning financial markets, financial instruments and financial conglomerates. Cross-sectoral trends in the capital market and in product development, as well as in the risk management systems implemented by financial services institutions for this purpose, are observed and analysed in order to make sure that the supervisory methods of the BaFin are regularly revised to take account of relevant innovations in the financial markets. Furthermore, this department deals with cross-sectoral accounting issues and coordinating tasks concerning the BaFin's participation in international supervisory forums. The BaFin is represented in many international forums, as for instance the Basel Committee on Banking Supervision or the Committee of European Securities Regulators (CESR). Moreover, it participates in the elaboration of homogeneous regulatory standards within the EU. Finally, various Memoranda of Understanding have been signed that are intended to improve cooperation on supervisory issues between the states involved.

The **second cross-sectoral department** mainly deals with issues relating to the protection of deposits, investor and consumer protection and retirement provision. The characteristic feature of this department - a central governmental body for issues concerning consumer protection - has been emphasised by the establishment of a call centre for consumer complaints. The department also deals with cross-sectoral legal and legislative issues. The responsibility of the third cross-sectoral department consists in combating money laundering and prosecuting illegal financial transactions. Thanks to the fact that all staff members charged with these tasks are concentrated in a single department money laundering and the provision of unlicensed financial services can now be fought much more effectively than in the past.

Administrative Council

The Administrative Council is a BaFin body of major importance. It supervises the executive level of the financial supervisory authority and advises it on how to fulfil its specific tasks. Moreover, the council decides on the budget of the BaFin, which is now completely funded by the companies it supervises. The Administrative Council is composed of 21 members and comprises representatives of the Federal Ministry of Finance and other ministries, members of the German Bundestag (Lower House of Parliament) as well as representatives of credit and financial services institutions and insurance companies. The Administrative Council is chaired by the Federal Ministry of Finance.

Advisory Board

Another body established at the BaFin is the Advisory Board, which comprises representatives of financial enterprises and consumer protection associations as well as academic parties. The principal function of the Advisory Council consists in providing general advice to the BaFin and - beyond its specific mandate - giving recommendations on the further development of supervisory practice. The Advisory Council provides a framework for the industries concerned, consumer protection associations and academic parties to become involved in the work of the BaFin.

Management

The management of the BaFin is comprised of the President, Mr Jochen Sanio, and the Vice President, Mr Karl-Burkhard Caspari.

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