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Experience of an integrated financial supervision system on the German model from the perspective of an insurance regulator

Since 1 May 2002 Germany has had an integrated financial supervisory authority, the Bundesanstalt für Finanzdienstleistungsaufsicht, known as BaFin for short. BaFin brings together under the one roof the three former Federal Supervisory Offices covering banking, securities trading and the insurance industry. Germany therefore now has one single all-embracing government regulatory authority responsible for the supervision of credit institutions, financial services institutions, insurance undertakings and securities trading.

History (of insurance supervision)

Consistent state supervision of Germany's insurance sector has a track record spanning a period of more than 100 years. It evolved from the *Reichsgesetz über die privaten Versicherungsunternehmungen* (Reich Act Concerning Private Insurance Undertakings), which was passed on 12 May 1901 and came into force on 1 January 1902. This legislation provided for the creation of a *Kaiserliches Aufsichtsamt für Privatversicherung* (Royal Supervisory Office for Private Insurance) in Berlin, which took up its duties on 1 July.
Following the unconditional surrender of the Third Reich on 8 May 1945, the all-embracing structure of insurance supervision collapsed in its entirety. The Reich's Supervisory Office no longer existed, and the Allies assumed responsibility for insurance supervision. However, towards the end of 1945 efforts were made to re-establish insurance supervision in the three Western occupation zones and Berlin. The fragmentation of supervisory activities in post-war Germany was eventually considered to be counterproductive – as was the case in the period before 1901. Those involved in the debate surrounding a general overhaul of legislation agreed that the Act of 1901 should remain intact. On 4 August 1951 the *"Gesetz über die Errichtung eines Bundesaufsichtsamtes für das Versicherungs- und Bausparwesen"* came into force, thus paving the way for the creation of a federal office for the supervision of the insurance industry and building and loan associations. The newly established Federal Insurance Supervisory Office (*Bundesaufsichtsamt für das Versicherungswesen - BAV*), based in Berlin, commenced work on 1 April 1952. In fact, it was the first federal authority to be located in Berlin. The Office was responsible for monitoring private insurance undertakings and public *"Wettbewerbsversicherungs-unternehmen"* (public insurance undertakings engaged in competitive business) operating beyond a specific *Bundesland* (state within Germany's federal system). The Bonn-Berlin Act of 1994 covered the relocation of the Federal Insurance Supervisory Office from Germany's new capital to Bonn. The first steps towards relocation were initiated in August 1999, when the Federal Insurance Supervisory Office opened an office in Bonn; at the end of October 2000, the Supervisory Office completed its relocation to the former capital. The decision to create an integrated supervisory authority was formally taken on 25 January 2001. In a

press conference the Minister of Finance announced that the three Supervisory Offices were to be absorbed into one independent federal authority and that the functions and staff of the former Offices were to be brought together under one roof. Thereafter BaFin was to supervise the German financial market in its entirety as an integrated regulatory authority. Effective from 1 May 2002, the Federal Insurance Supervisory Office was amalgamated with the Federal Banking Supervisory Office (*Bundesaufsichtsamt für das Kreditwesen - BAKred*) and the Federal Securities Supervisory Office (*Bundesaufsichtsamt für den Wertpapierhandel - BAWe*) to become the Federal Financial Supervisory Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht - BaFin*).

Arguments in favour of the establishment of an integrated financial supervisory authority

The German legislation creating an integrated financial supervisory authority was a response to the changes that had been taking place on the capital markets. The structure of financial supervision is intended to reflect the real conditions prevailing on the financial markets, in order that the regulator can operate in a forward-looking manner.

Banks, financial services institutions and insurance undertakings have merged to become financial conglomerates. The regulator is faced with the challenge of properly capturing the risks arising as a result of cross-shareholdings and intra-group transaction within the conglomerates.

As a result of their business and competitive relationships on the capital markets banks, insurance undertakings and financial services institutions can transfer risks between themselves even without the existence of cross-shareholdings. Differences in capital requirements or accounting rules may distort competition and lead to regulatory arbitrage. The increasing integration of the financial markets also calls for a view of the whole system which can be provided only by an integrated financial supervisory authority.

Finally, the three groups of companies compete for the savings of private households with similar or even identical products.

The boundaries between the individual sectors and the traditional distinctions that formerly applied to all forms of company and all types of products and distribution channels are breaking down.

In the light of these developments, which were and still are continuing by leaps and bounds, the government's view was that the concept of three separate supervisory authorities was no longer suited to the times. The government was of the opinion that only a cross-sectoral all-embracing financial supervisory authority could ensure the stability of Germany as a financial centre on a lasting basis. An integrated financial supervisory authority was the only way of achieving consistent regulatory treatment of identical or similar cases.

Starting position as of 1 May 2002

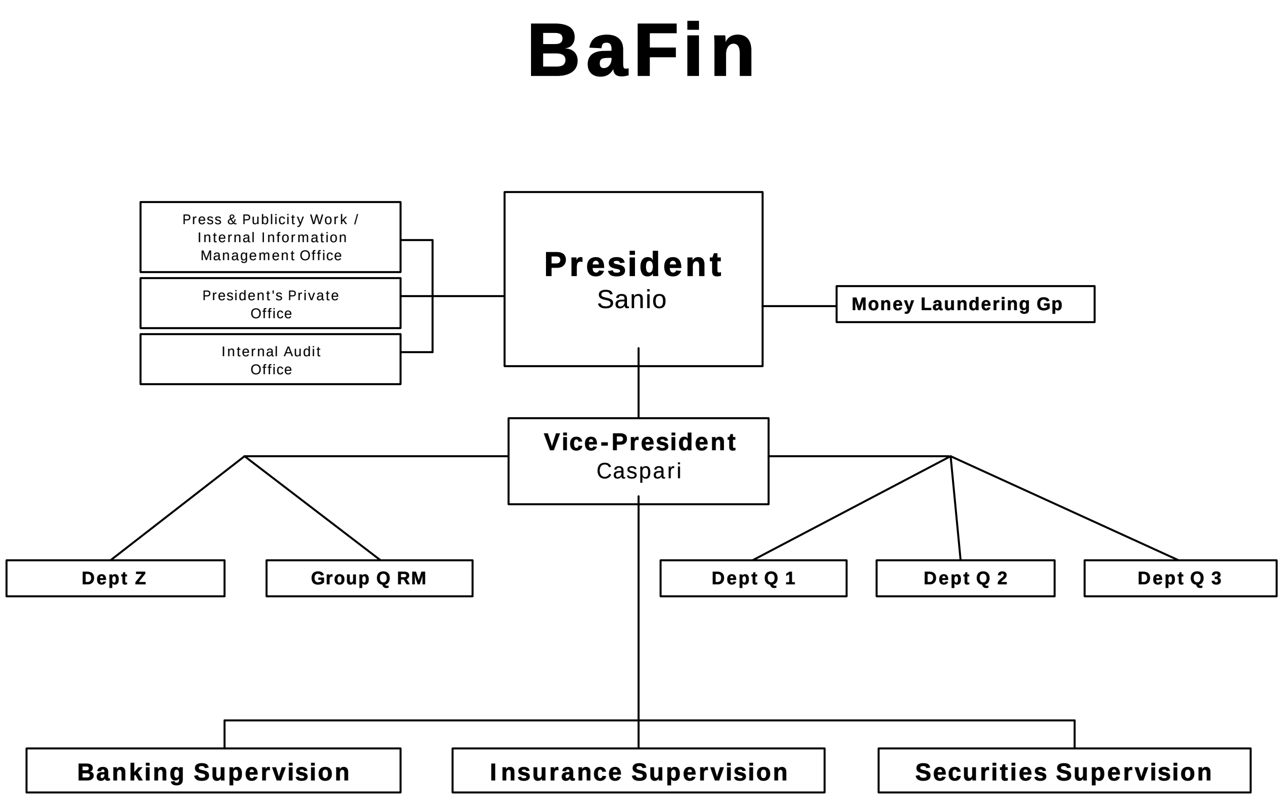
1 May 2002 was the first day of the new BaFin's existence. However, for all members of staff of the three former supervisory offices it was just another

working day. Changes of a personnel and structural nature were and are being implemented only on a gradual, step-by-step basis. This is also undoubtedly due to the fact that the period from the decision to create an integrated supervisory authority to the actual implementation was very short (15 months). For example, Dr. Müller remained in charge of insurance supervision until end-June, while Herr Sanio, the former President of the Banking Supervisory Office, became President of BaFin and thus Dr. Müller's superior. This arrangement was not easy for all those concerned. Following Dr. Müller's retirement, it took until October 2002 for a new First Director for insurance supervision to be found. Staff naturally felt anxious, since nobody knew precisely what was in store for them.

BaFin's organisational structure

BaFin's organisation is not static but is an ongoing process. In an agency which by now employs more than 1,200 people it is not possible to implement radical restructurings overnight. Smaller step changes are decided instead.

BaFin's organisational structure currently looks as follows:



Supervision of banks, insurance undertakings and securities service providers is still carried out in three separate organisational units, known as Directorates. They are responsible for solvency and market supervision. Functions extending across more than one area of supervision are assumed by three cross-sectoral departments (Departments Q 1, Q 2 and Q 3).

The Head of BaFin is the President, Jochen Sanio, who is assisted by Karl-Burkhard Caspari as the Vice-President. The three Directorates each have their own Head, known as First Directors; for the Insurance Supervision Directorate this is Dr. Thomas Steffen.

Directly attached to the President's Office is an Anti Money Laundering and Funding of Terrorism Group - a function to which BaFin attaches particular importance, especially since the terrorist attacks of 11 September 2001. Also reporting directly to the President are the Press and Publicity Work / Internal Information Management Office, the President's Private Office and the Internal Audit and Data Protection Office, which are shortly to be joined by the Project Management Office.

Like the cross-sectoral departments, the Central Administration Department (Department Z) reports directly to the Vice-President. Among other things, it deals with BaFin's budget, cost-to-performance calculations, personnel matters and IT matters.

Group Q RM is responsible for issues of principle regarding the quantitative mathematics modelling of market, credit, liquidity and operating risks and carries out on-site inspections of these models. It continues to participate in the further development of regulatory law, where it brings its market expertise to appropriate working groups. In the medium term the Group is also scheduled to assist in the supervision of insurance undertakings and investment companies, not least because of current developments in international regulatory law (e.g. Solvency Directive II or hedge funds).

While the aforementioned departments and groups existed in a different form even before BaFin came into being, Departments Q 1 to 3 are largely new. These three BaFin cross-sectoral departments perform functions covering all overlapping areas of supervision. They collaborate closely with the Banking, Insurance and Securities Supervision Directorates, in order to ensure that a sensible balance is always struck between their respective peculiarities and the cross-sectoral aspects of supervision.

Department Q 1, Financial Market and International, which is currently still being built up, handles cross-Directorate subjects. The concept of one-stop financial services on which the creation of BaFin was based is reflected particularly strongly in this Department. One of its functions is to plan BaFin's strategic and technical objectives. Among other things, the Department deals with matters relating to the supervision of financial conglomerates and with the accounting and disclosure practices of banks and insurance undertakings. It monitors and analyses developments on the national and international financial markets. In this way due account of current developments can be taken in BaFin's supervisory practices in a timely fashion. The responsibilities of Q 1 also include developing appropriate supervisory strategies in response to new challenges.

Department Q 2 deals with fundamental issues of consumer protection. But it also handles specific queries and complaints regarding banks, financial service providers and insurance companies. Q 2 is also responsible for the certification of pension plan contracts. In future Department Q 2 is also scheduled to take on the auditing of the existing protection schemes - i.e. the deposit protection and compensation schemes.

Department Q 3 deals with issues of principle and legal questions in connection with proceedings against unauthorised or prohibited banking and insurance business and financial services. In addition, Q 3 takes legal proceedings against such business. Under the relevant supervision legislation (the Banking Act and the Insurance Supervision Act) the unauthorised carrying-on of banking, financial services and insurance business is punishable as a criminal offence.

Overall , BaFin is divided into 17 Departments, three Groups, around 130 Sections and three (four) Offices.

BaFin consultative bodies

BaFin is supported in its work by a number of different bodies. In what follows below I shall mention only those bodies which are also of relevance for insurance supervision:

Administrative Council

The Administrative Council supervises the executive level of the Federal Financial Supervisory Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht – BaFin*) and supports management in an advisory capacity. In addition, it is responsible for deciding on BaFin's budget, which is funded completely by the companies it supervises and is thus no longer covered by the federal government's budget. The President of BaFin is obliged to report to the Administrative Council on a regular basis.

The Administrative Council meets twice a year. It comprises 21 members. The chairmanship and deputy chairmanship are held by representatives of the Federal Ministry of Finance, which designates four representatives in total. The Federal Ministry of Economics and Labour and the Federal Ministry of Justice designate one representative each. The Bundestag is represented by five members of parliament. The credit institutions which are subject to official supervision are entitled to appoint five members, while insurance undertakings designate four representatives and investment companies one representative.

Advisory Council

The Advisory Council is responsible for advising BaFin on issues related to its supervisory duties. Furthermore, it assists BaFin in developing and enhancing supervisory policy.

The Advisory Council brings together 24 experts from the field of finance, banking and insurance, as well as representatives from consumer protection associations and the Bundesbank. The Advisory Council meets twice a year.

Insurance Advisory Council

The Insurance Advisory Council discusses issues related to insurance supervision and advises BaFin when it comes to applying and improving supervisory law. In some cases, the Insurance Advisory Council must be consulted in accordance with the provisions of the Insurance Supervision Act (*Versicherungs-aufsichtsgesetz – VAG*). The Council comprises representatives from every segment within the insurance sector, qualified policyholders within the field of industry, commerce, trade, transportation, agriculture, real estate ownership, the legal/medical/business professions and civil service, as well as members of trade unions, insurance intermediaries, insurance employees, academics specialising in insurance and other experts within the field of insurance.

Forum for Financial Market Supervision

The Forum for Financial Market Supervision, in which the Bundesbank is also represented, is responsible for coordinating joint activities between BaFin and the Bundesbank within the field of banking supervision. It also discusses issues related to integrated financial services supervision, in particular those which are of importance to the stability of the financial system as a whole.

The Agreement of Cooperation between the Federal Banking Supervisory Office, the Federal Insurance Supervisory Office, the Federal Securities Supervisory Office and the Bundesbank was signed on 3 November 2000.

(Securities Council

The Securities Council advises the BaFin on issues related to securities supervision, e.g. in connection with regulations or special guidelines to be issued by the BaFin. The Securities Council is also authorised to put forward its own proposals aimed at enhancing the BaFin's regulatory processes.

The BaFin is obliged to inform the Securities Council at least once a year about its supervisory activities, any developments within the field of supervision, and international cooperation.

Each *Bundesland* (i.e. state within Germany's federal system) designates a representative as a member of the Securities Council. Meetings convened by the Securities Council may also be attended by representatives of the Federal Ministries of Finance and Justice, as well as representatives of the Federal Ministry of Economics and Labour and staff members of the German Bundesbank. The Securities Council may also approach experts from the fields of business and academia.

Takeover Council

The Takeover Council assists the BaFin in monitoring corporate takeovers. It advises the BaFin on issues related to securities acquisition and takeovers, e.g. when it comes to issuing regulations connected with its supervisory duties.

The Takeover Council comprises fifteen members: four representatives designated by issuers, two representatives each chosen by institutional and private investors, three representatives selected by investment services enterprises, two employee representatives, and two representatives from academia. The members of the Takeover Council are appointed by the Federal Ministry of Finance for a period of five years.

The President of the BaFin convenes and presides over the meetings of the Council. He may also designate a BaFin member of staff to perform these duties.)

Challenges

The amalgamation of three autonomous authorities into one is an enormous challenge for all those involved. The three supervisory offices have completely different histories and cultures. The Federal Insurance Supervisory Office is by far the oldest authority (101 years old). The Federal Banking Supervisory Office was established in 1962 and the Federal Securities Supervisory Office in 1994. The (supervisory) cultures are correspondingly different. While the Insurance Supervisory Office saw itself primarily as a consumer protection agency, the Banking Supervisory Office's objective is solvency supervision and the Securities Supervisory Office sees itself as a market supervisor. These objectives are also enshrined in the respective supervision Acts. For this reason the individual authorities were set different priorities.
In insurance supervision, for example, dealing with complaints is a major consideration, part of consumer protection. In banking supervision there is virtually no provision for this at all. All there is in this area is the Banking Ombudsman, and securities supervision does not deal with any complaints. So to start with, it was very difficult to make the new senior management team, who all come from the world of banking, understand why dealing with complaints is important. By now there is even a call-centre for insurance complaints.

To my mind there is a problem in the fact that senior management, i.e. the President and Vice-President, come from the world of banking. The President, Herr Sanio, was President of the Banking Supervisory Office and the Vice-President, Herr Caspari, was Deputy Head of Department in the Federal Ministry of Finance and a banking expert. For this reason the Insurance Supervision Directorate has often had and still has to fight for senior management understanding for special insurance problems and needs. A further problem arising from this is that many insurance supervision staff feel that they are being swallowed up by Banking Supervision in a sort of "hostile takeover". Many members of staff, particularly on the insurance supervision side, had and still have a feeling of not being properly understood and represented and of being swallowed up by the banking culture. In many cases it may perhaps be only a subjective feeling, but the integration of all members of staff into BaFin is made considerably more difficult as a result of this feeling.

However, a very great deal is also being done to integrate all members of staff into BaFin, to create a common "corporate culture". For instance, a BaFin "Mission Statement" has been drawn up, setting out BaFin's functions and objectives. On the personnel front, it has this to say: "For our supervisory work to succeed, all employees have to be dedicated and reliable. With their first-rate qualifications, commitment and sense of responsibility, backed up by ongoing professional training, our staff are equipped to fulfil their tasks effectively.

Along with the required expertise, they also possess the social and communication skills essential to teamwork in a modern organisation.

The management style at BaFin is cooperative, based on trust and the agreement of clearly defined goals. It is aimed at motivating employees, strengthening their sense of responsibility and recognising their achievements. A comprehensive personnel development programme will help staff rise to the growing challenges within BaFin."

This year, for the second time, a summer fête was held in the grounds of BaFin, which went down very well. In addition, all members of staff were given the opportunity to take part in three different day trips. This offer, too, was taken up. These activities help staff to get to know and understand one another and grow closer together.

In order to promote the single "face" of BaFin, a BaFin corporate design was introduced a short while ago. It is meant to provide a visual representation of BaFin both within the organisation and without. It is not just a logo but encompasses the standard design of all visual components of BaFin (including letters, visiting cards, greetings cards, note-pads, circulation folders, digital media). The main feature of the corporate design is the watermark, which is also used as a design element on banknotes.

The Mission Statement, on the other hand, is meant to serve as a guide for BaFin on what it is aiming to achieve and how it intends to go about it. It includes fundamental guiding principles and values which are meant to influence the attitude and integration of staff. All members of staff are meant to identity with the BaFin Mission Statement, so that the cultures of the three supervisory offices can become one. The Mission Statement contains precepts on the following subjects: "Who are we?", “What do we stand for?", "Reasons for one-stop financial services", "Nature of supervision", "Staff motivation”.
The BaFin Mission Statement is attached as an annex.

A further problem is finding a suitable and functioning organisational structure for BaFin and identifying synergies and surplus capacity. For this reason, this spring a firm of chartered accountants was instructed to find this out. The first investigations have been completed, but it is still too early for any concrete results.

A further challenge is the fact that BaFin is located in two sites, Bonn and Frankfurt. Securities supervision, with about 300 staff, is based in Frankfurt and will also remain there for the foreseeable future. That is certainly not an optimal situation, but modern technology (telephone, E-mail, video-conferencing) means that Bonn and Frankfurt can communicate with each other without any difficulties. Furthermore, the distance between the two cities is not too great - about 2 hours by car - so that for face-to-face meetings it is possible to travel there and back in a day.

Advantages and disadvantages of integrated financial supervision

The amalgamation of three autonomous supervisory authorities with different cultures has advantages and disadvantages.

Disadvantages of integrated financial supervision

As of 1 May 2002 BaFin had around 1,000 employees from three different supervisory offices. Many were not enthusiastic about the merger at all. They were afraid of the unknown, of a restructuring, of a change of work-place. No-one was afraid of losing their job, since under the law civil servants in Germany cannot be made redundant. The uncertainty about the future caused great anxiety, which has by now partly subsided.

The amalgamation of agencies each of which has its own infrastructure means that centralised areas in particular, such as Personnel or IT, are now triplicated. This means that not only do different systems have to be made compatible but also new jobs have to be found for many members of staff, since not all of them were still able to keep their old jobs. Success in resolving this problem has been limited up to now. Many centralised areas still have too many members of staff. But too many members of staff also means that many operating processes take longer than necessary.

Advantages of integrated financial supervision

I have already mentioned many advantages of integrated financial supervision a short while ago under arguments in favour of integrated financial supervision (financial conglomerates, similar products, better view of the system). In addition, because of its extensive powers and its complete overview of the market the new Federal Authority is able to take consistent and efficient decisions in the interests of the stability of the financial system. The creation of BaFin means that Germany now has a central contact point for all the various companies involved. For the financial companies operating in Germany and their customers this is a plus point. Cooperation with foreign supervisory authorities is also made much more efficient. One example of this is the cross-sectoral (banking and insurance) Memorandum of Understanding soon to be concluded with the Canadian supervisory authority, the Office of the Superintendent of Financial Institutions. Furthermore, the voice of the new German financial market regulator supervisor carries much greater weight in international negotiations on regulatory matters, so that specific German interests can gain greater acceptance.

A further advantage of the new organisation is the fact that BaFin, which is 100%-funded by the industry, can draw up its own budget. This means that the funds at its disposal can be employed where they are needed. The previous system was much more inflexible. The salary system has also become more flexible, so that it is possible to employ experts who are much better paid than "normal" supervisors.

One advantage for staff is that it is possible to switch between operating areas, e.g. from insurance supervision to banking supervision. This promotes understanding and lets members of staff themselves learn something new. There is also a great deal of interest in BaFin in switching jobs.

Concluding remarks

Due to increasing internationalisation, financial services companies will be facing great challenges and – for all sorts of reasons – dangers. This means that supervisory authorities, too, have to react appropriately. World-wide, they have to reinforce supervision of financial institutions. The increase in quality which is required in this respect cannot be achieved by the usual means available to the public administration. The powers of the new integrated authority cover, from a prudential point of view, the supervision of the widest range of financial institutions. On the market supervision side, consumer protection, market transparency and market integrity are BaFin's pre-eminent goals, which have to be accomplished by formerly separate regulators now working together. The most important factor for the success of BaFin are motivated and committed staff. President Sanio said in one of his speeches: I would prefer to make the famous motto from Alexandre Dumas' novel "The Three Musketeers" the campaign slogan for building the new institution: "All for one, one for all".

I think BaFin is making great progress.