



Position Paper – Munich Financial Center Initiative

Presentation on 1 February 2006 in Brussels

Core statements

Payments Directive:

- Approval of an EU Directive to introduce a European-wide direct debit procedure; no discernible need for regulation beyond this
- Rules restricted to the consumer domain in each case

Consumer Credit Directive:

- Consumers must still have the option to obtain a loan quickly
- No superfluous information obligations
- Right of withdrawal should be welcomed if pre-contractual information obligations do not apply

Mortgage loan:

- No discernible need for European harmonisation
- Product variety should be retained

MiFID:

- Closed order book must be retained
- All execution venues must be included in the scope of best execution

IAS:

- Restricted to capital market-oriented companies
- No additional accounting obligations or other complication of rules for SMEs
- No destruction of equity by IAS 32



I. Heavy regulation and regulation gap in the EU

The regulation gap and excessive regulation hinder the consolidation objective in the EU economic area.

In conjunction with the Lisbon Strategy of 2000, the European Union is striving for dynamic consolidation in financial market policy. The Financial Services Action Plan (FSAP) programme is also geared towards this. At the same time, better regulation is a secondary objective tied in with dynamic consolidation.

The positive effects on growth of European financial market integration are indisputable in principle. Nevertheless, implementation of the Financial Services Action Plan and the resulting guidelines has created strong pressure for it to work among the national ministries responsible and among the companies concerned. So if the European Commission pursues consolidation over the next few years in the sense of better regulation as well as implementation and evaluation of the enacted provisions, this should be welcomed.

Irrespective of this, tendencies towards excessive regulation should be avoided when harmonisation is linked to the consolidation objective. The fact that Germany has a deficit of 0 percent in implementation of EU standards already constitutes a noticeable regulation gap between the individual EU states.

Deeply rooted market and legal structures in the member states should also remain in place if purely domestic matters are affected. Incidentally, this goes well with the subsidiarity principle which is actively supported in the European Union. It must also be taken into account when consolidating cross-border markets that market and product structures developed regionally should not be burdened with excessive regulation.

In all harmonisation and consolidation activities, it must be borne in mind that there is a considerable regulation gap between the individual member states of the European Union. There is still a long way to go before a level playing field is created for all market participants. Different provisions make for unequal competitive conditions, e.g. in the case of the account retrieval procedure under Section 24 c of the German Banking Act (KWG). Austrian banking confidentiality, for instance, is legally guaranteed.



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In contrast, banking confidentiality in Germany is breached in many cases because of legal regulations. In the case of the German Interest Information Regulation (ZIV) as well – the aim of which is uniform taxation of interest income – an exemption was permitted in Austria, for example.

The lending economy desperately needs a break from regulation to safely achieve the EU's consolidation objective.

This can be explained, among other things, by the following points:

1. “Excessive and unnecessary bureaucracy impairs freedom and economic and civil development possibilities”. With these introductory words on the homepage of the Initiative to Reduce Bureaucracy, the former Federal Government espoused this cause, which is such a key concern for Germany's economic development. The new Federal Government also laid down the ongoing reduction of red tape and excessive regulation in its coalition agreement.

However, it is not enough for the national government and the local banking supervision to reduce the rules to a minimum. It is primarily the “lawmaker Brussels” that must be checked, as principal regulations originate from the EU and force the hand of national government and supervision.

Especially the banking industry was and is being overwhelmed by one EU bureaucracy avalanche after another. This also has structural policy effects as small and medium-sized institutions are no longer able to stem the tide of regulation. However, SMEs are also notably stunted in their growth by excessive red tape.

2. The fact that there is still far to go until equal competitive conditions are created in the sense of a level playing field in the EU is apparent through the implementation of the EU Interest Directive clear. The EU had already agreed in 2003 on protecting cross-border taxation of interest income by automatically exchanging information on interest payments between member states. After an agreement on withholding tax deduction was reached with Switzerland, the EU Interest Directive entered into force on 1 July 2005 and was implemented in Germany by the ZIV.



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22 EU states have subscribed to this procedure, which is used to provide information if interest payments are made to citizens of a member state. However, Austria, Belgium and Luxembourg are still not passing on any information about the interest income of foreign investors in their home countries. Instead, these states are (only) levying withholding tax, initially of 15%. After three years, the withholding tax rate increases to 20%, until it is raised to 35% from 2011. Tax advantages thus arise in the countries mentioned in the short to medium term at least.

The special status granted to Austria results in substantial distortions of competition for Bavarian credit institutions. It is likely to influence investor behaviour noticeably. Banks and savings banks in particular whose operational sectors are close to the border report massive outflows of capital in the deposit business. This trend is strengthened by the fact that Austrian banking confidentiality is legally guaranteed and thus rates significantly higher than in Germany where banking confidentiality is breached in many cases due to legal regulations vis-à-vis the state. In this context, another main factor is the automated account retrieval system, originally introduced to combat money laundering and terrorism in Germany, which has now been expanded considerably and enables a large number of authorities to request account master data under certain conditions. Such a procedure has not been installed in Austria to date due to the extensive protection of Austrian banking confidentiality.

This example clearly shows that there is still a considerable need for harmonisation in many areas.

On the other hand, there are fields of action in which minimum harmonisation within the EU is sufficient instead of complete harmonisation.

In addition, care must be taken to ensure – and this is a fundamental problem – that the Consumer Credit Directive is coherent with other guidelines, for example, which partially overlap with the former as regards the regulatory field of consumer credit law (e.g. the Distance Selling of Financial Services Directive). It is this very lack of directive coherence that leads to a “regulation hullabaloo”, additional costs that are considerable and unnecessary as well as to serious legal uncertainties which can only be detrimental to genuine consumer protection. However, the European Commission pursues a harmonisation dogma in various areas with which tendencies towards excessive regulation are aided and abetted.



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The Commission still does not have a convincing concept to tackle consolidation of cross-border markets as regards regulation without encasing regionally developed market and product structures in excessive regulations.

3. Admittedly, the Commission's announcement in the Green Paper on Financial Services Policy for 2005 to 2010 to prioritise implementation of existing European rules into national law, assessment of their effects on practice and, if necessary, their consolidation over the next five years before enacting new legal provisions is very welcome, because improvement of regulation quality is urgently needed. However, it is crucial that the Commission's proposals for better regulation – for example in terms of a transparent consultation procedure and detailed impact assessment – are also actually put into practice.

These principles must also be systematically implemented in conjunction with legislative procedures that are already ongoing. This is not the case, for example, in the revision of the Consumer Credit Directive. An impact assessment has been waived to date, although all interested groups – including the consumer associations in addition to the representatives of the banking industry – have repeatedly pointed out that the proposed rules would make lending to customers considerably more difficult and would result in cost increases.

Another focal point in this context is the integration of mortgage lending markets in the EU. In this respect, the Commission has neither demonstrated sufficiently to date that there is a need for harmonisation nor has it produced evidence that a possible benefit would balance out the related costs.

The Commission's current directive proposal to implement a standard euro payment area is also inducing fears of excessive regulation. As a result, the requirements, which are very detailed in part, will interfere unreasonably with the product design and pricing of the institutions.

There is also a need for action in expansion of the financial market structure and the integration of retail markets (e.g. pan-European pension plans). As regards contract law and consumer protection, there are still considerable differences within the EU. Common consumer protection standards and minimum harmonisation of contract law would be necessary.



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Regulation (EC) No. 809/2004 of the Commission from 29 April 2004 to implement the Prospectus Directive can be taken as another important example. It is the core element of the new prospectus and listing law which entered into force on 1 July 2005. Some relief for large international issues is contrasted by difficulty for the IPOs of small and medium-sized companies (SMEs). In view of the comparatively weak equity ratios of small and medium-sized companies as well as the superior significance of SMEs for the German economy, this is dramatic.

According to the Regulation, audited historical financial information from the last three financial years and an auditor's report for each financial year must be included in the prospectus. The auditor's certificate must not only extend to the respective balance sheets with P/L statements, but also to a cash flow statement prepared separately for each financial year. If the issuer has subsidiaries, consolidated financial statements must be prepared retroactively in accordance with international accounting standards and audited.

However, SMEs that want to go public to improve their equity situation do not have audited financial statements or even an audited cash flow statement in the absence of a legal obligation to prepare them. The same also applies to consolidated financial statements in accordance with international standards. Thus to prepare a prospectus new audit reports, which are both time and cost intensive, have to be drawn up retroactively. IPOs on the Munich Stock Exchange have already had to be postponed because of this.

As regards the compulsory prospectus contents, differentiation by the type and size of the issuer would perhaps have made sense. Companies that do have the audited accounts required due to legal provisions or the business model should record these in the prospectus. Forcing companies to have previous financial years examined and audited again in accordance with accounting principles that were not applied originally does not seem appropriate and hinders the IPOs of SMEs. A change to the Regulation would therefore be desirable. This applies all the more as transactions designed to avoid a prospectus entirely can already be seen, thwarting the purpose of the law to better inform investors.

All these developments are neither in the interest of customers, nor in the interest of the entire German economy.



II. Directive on payment services in the internal market

1. Third country rule

The rule provided for in Art. 2 (1) sentence 1 would lead to European payment provisions being applied if only one party were domiciled in the EU. Such a rule goes too far because the risk involved in settling these payments outside the EU for the European banking industry is incomparably higher than for transactions within Europe. It would impose considerable risks on the European credit institutions which they would not actually be able to control on a large scale and which would have to lead to rejection of certain payments where applicable.

In Regulation No. 2560/2001 of the European Parliament and of the Council from 19 December 2001 on cross-border payments in EURO, third countries with the exception of the EEA states have been deliberately excluded. This must also apply to the matter at hand.

If the third country rule is still retained against considerable reservations, it should be restricted in any case to the actual territory of the EU credit institutions. Insofar as the banks used as intermediaries and the recipient bank are to be assigned to the “territory” of the principal bank, the third country rule would be able to provide for liability. Consideration would have to be given to whether the term “territory” includes those foreign banks with which the principal bank has concluded extensive cooperation agreements for payment services.

2. Liability of the user for losses caused by unauthorised payment

The limitation of liability regulated in Art. 50 (1) sentence 1 up to a maximum of €150.00 which arises in the case of slight negligence by the payment service user is still not convincing.

If it related solely to amounts available from cash dispensers, it would be acceptable in view of the new rule concerning gross negligence under Art. 50 (2). However, if the entire electronic banking field is included, consideration must still be given to the fact that millions can be transferred electronically (“by computer”) for which liability would effectively be limited to €150.00 due to the unfavourable evidence position for credit institutions (electronic banking is regularly accessed in



areas that are beyond the control of the banking industry, such as from company or home PCs). We still believe that equal legal treatment of the entire electronic banking field with card withdrawals at cash dispensers is completely excessive, unpractical and not supportable. It would just open the floodgates to misuse.

Should the current version of Art. 50 still remain unchanged, Art. 48 at least would have to refer to the special civil procedures in the individual EU states, leaving the channel for decisions that are still appropriate open in local court practice in this respect. In line with this, Art. 48 (4) should contain a general note that matters of evidence must be solely based on the procedural law of the respective country.

3. Duration of payment transactions

The payment period, which is now mandatory from 1 January 2010 at the latest, of one day after acceptance of the order (Art. 60 (1) sentence 1) is also not realistic even if viewed optimistically, even if the order is in the EURO currency. This is because the payment systems of the 25 states are incompatible in many areas. To meet the requirements here, investments of approximately several billion EURO would have to be made to adapt the electronic systems of the 25 states.

4. No service provider liability for unauthorised payments

The present rule under Art. 49 contains no time limitation of liability. This is particularly disadvantageous for market participants because – for German direct debit authorisation at least – the participating credit institutions are often not aware of the missing authorisation, with the result that losses can still occur years later for which recourse claims against the party presenting the direct debit for payment are no longer economically enforceable. It must be notably taken into account here that the cross-border direct debit payments are between credit institutions that do not often maintain any direct business relationship with each other. It seems appropriate to establish irrevocability between the credit institutions in any case for these payments one year after they are made.



5. Refund for authorised payments

According to Art. 52, a payer acting in good faith should have a claim to refund of payments if the exact payment amount is not fixed at the time of authorisation or the identity of the payee cannot be identified or if the payment executed does not correspond to the amount that normally has to be paid. The first and the third alternative lead to legal uncertainty here for direct debit payments which were previously considered final by the market participants. In Germany, this leads to uncertainties for preauthorised payment methods. As to the legal certainty particularly required in payment transactions, there should be no imponderability where authorised payments are concerned. Art. 52 must therefore be modified in our opinion.

The content of Art.53 (2) also raises considerable questions of interpretation. At best, the rule under Art. 53 (2) should therefore stipulate that the payment services provider should refund the payment transaction amount within 10 business days of receipt of the refund order in accordance with (1) when the requirement is presented in accordance with Art. 52.

6. Authorisation of credit institutions

The criteria specified for authorisation of payment service providers (Art. 5 ff) means that that they are better positioned than the banks to date. This is not justifiable from a local perspective for the protection of the payer and the payee. The settlement of payment transactions creates considerable risks for payment transaction participants if a participant has weaknesses in credit standing terms. The risk of insolvency is widely minimised for banks because they are strictly monitored by supervisory authorities. This would not be the case for a mere payment service provider under the current version of the Directive and could lead to unsustainable results.

7. Approval of the payer

The stipulation in Art. 41 (2) that authorisation must be “expressly” granted goes too far as it does not correspond to legal truth. In addition, authorisations are often made “non-expressly”; the payer wants to conduct the transaction with a conclusive declaration.



8. Availability of funds in a payment account

Art. 65 (1) stipulates that members states shall ensure that the payment service provider of the payee makes funds available to the payee as soon as those funds are credited to the payee's payment account. In contrast, it is established in (2) that the payments service provider of the payer shall cease to make funds available to the payer as soon as those funds are debited from the payer's payment account. The question here is which rule this provision contains.

III. Consumer Credit Directive

1. Limitless extension of the linked credit agreement (to Art. 3 (1) (ii))

The rule which must be cancelled without limit and replacement is the rule where by a linked credit agreement already exists if it "makes reference to the specific goods or services to be financed with the credit". Every credit relates to financing of a good or service. As a result of this, every credit agreement would be void as soon as the consumer could revoke an agreement for the supply of goods or services and did so (Art. 14 (1)).

2. Excessive information obligations (to Art. 4, 5, 6, 9)

- Standard information in advertising superfluous

Standard information in advertising is superfluous as the consumer already has to be informed verbally and in writing after the proposal but before conclusion of the agreement. There are also sufficient rules at European level which protect consumers against unfair advertising.



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- Precontractual information superfluous

Contrary to the ZKA's statement, we not only believe that this information obligation is excessive in terms of content, but that it is also completely superfluous when taking consumer protection into account. The pre-contractual information is supposed to allow the consumer "to compare different offers" (reasons for proposal under 5.4). The right of withdrawal also fulfils the same purpose. It should allow the consumer "to shop around after conclusion of the agreement and possibly to find a better offer" (reasons for proposal under 5.7). A double right to „shop around“ is not required under the consumer protection aspect. Finally, the obligation to provide pre-contractual information calls the meaning of the right of withdrawal into question.

- Verbal information and advice obligations disproportionate

The Commission creates new facts constituting liability at the expense of the credit institutions. In all cases in which the consumer can no longer repay the loan, he/she can try to assert claims for damages against the credit institution and maintain that it was the credit institution that did not sufficiently explain the disadvantages of a credit agreement to him/her. Evaluating the advantages and disadvantages of an individual credit agreement always contains subjective aspects as well which escape a final assessment by the credit institution. The rule blatantly contradicts the model proclaimed by the Commission of the informed consumer. The additional liability risk will inevitably lead to credit institutions being more reserved when lending with the result that access to borrowing will be made more difficult, particularly for consumers with low credit standing.

- Right of withdrawal

Should the existing right of withdrawal be retained (already the case in Germany as the law currently stands) or introduced throughout the EU, the pre-contractual information obligations become superfluous (see above). In each case, rights of withdrawal from different directives with different contents must be prevented from acquiring validity (consumer credit law, distance selling law).



3. Excessive information obligations in the case of overdraft facilities (to Art. 6, 9)

The Commission does not give consideration to its self-declared claim of providing for only “a few” information obligations for overdraft facilities (i.e. authorised advances on current accounts). In contrast, the scope of the information obligations does not differ substantially from the other credit agreements. The area included in the current version of the Directive for overdraft facilities must be retained. In addition, a conflict rule should be clarified stating that only the provisions of the Consumer Credit Directive should apply to overdraft facilities which were granted through distance selling (unless expressly agreed otherwise).

4. Improper liability risk through the principle of responsible lending (to Art. 5 (1))

The Commission turns the obligation that already exists at present under banking supervisory regulation to carry out a credit standing check into a civil law obligation to the consumer. It thus creates more new facts constituting liability at the expense of the credit institutions. In all cases in which the consumer can no longer repay the loan, he/she can not only claim for damages owing to a supposed lack of explanation about the “disadvantages” of the credit agreement (see above), but also due to absence of an examination of his/her credit standing. The rule also contradicts the model proclaimed by the Commission of the informed consumer.

5. Right of the consumer to repayment at any time without good cause (Art. 15 (2))

The rule results in an unlimited right of withdrawal which will reduce the willingness of credit institutions to make longer economic commitments through fixed rate loans which generally have to be funded to this effect. In any case, it is unreasonable to deny the lender early repayment indemnity in the event of termination by the consumer under certain conditions. Subsections (a) and (b) should therefore be cancelled.



6. Assignment of claims (to Art. 16)

The rule should enable the credit institutions to transfer credit risks to third parties by transferring the credit agreement. However, the wording of this formulation is unfortunate. According to the formulation, only individual claims from the credit agreement can be transferred and not the credit agreement itself. The formulation should be amended accordingly.

7. Exception for loans of negligible amounts (to Art. 2 (4) (a))

Loans of negligible amounts have to be exempt overall from the Directive's scope of application, as before. It is not obvious that the present industry-wide exemption would have caused problems in the past. A minimum limit could be € 500.

IV. Mortgage loans in the EU

The European Commission is considering a legal initiative in the area of mortgage loans to stimulate the further integration of the European mortgage lending markets.

The assumptions below should be taken into account for further consideration:

1. The mortgage lending business is local business for consumers

Due to the complexity of real estate finance and the knowledge of local markets required, it is not very likely that distance finance will play a larger-scale role over the next few years. While the London Economics report commissioned by the European Commission found that further steps towards integration would lead to GDP growth of 0.7%, however, this is yet to be sufficiently proved. The growth potential calculated seems to be based on assumptions and corresponding model calculations that are not plausible without further consideration. It has therefore not yet been displayed sufficiently that integration in the mortgage loan area would actually lead to substantial added value for market participants. However, such likely added value must be a requirement for the European legislator to act.



V. Solvency II

The insurance industry supports the Solvency II Project of the EU Commission. Solvency II will result in risk-based capital requirements which are more commensurate with the economic reality of business than the present solvency system. The project represents a significant challenge for both the economy and the regulators. It is of crucial importance to the insurance industry that the practice for determining risk-adequate capital requirements developed by companies will be taken into consideration in the future solvency system.

Solvency II aims to base solvency requirements on a company's financial situation. However, there is a tendency to also demand security surcharges in the assessment of liabilities as well as investment restrictions and limited permissibility for investments affecting core capital – in addition to the required risk-based solvency capital. Every reasonable financial approach ought to achieve consumer protection via sensible capital requirements – and not through implicit security surcharges in the assessment of liabilities, combined with additional restrictions. Not to comply with this principle would potentially double the burden and result in a general loss of transparency.

The following are among the insurance industry's most important requirements of Solvency II: a consistent solvency system for single units and groups taking into consideration diversification effects at the single and group level; the introduction of efficient supervisory structures (lead-supervisor concept); no excessive prudence in the solvency system; incentives for the development of internal models (but no restrictions as to how these are set up, e.g. as under Basel II).

Essentially this means:

- A risk-based supervisory system must offer incentives for a realistic risk assessment via internal risk-capital models.



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- The future supervisory system should be based more on principles than on rigid rules. Only in a system based on principles can supervisors evaluate the individual circumstances of an insurance enterprise and decide on suitable measures, without triggering automatic procedures linked to fixed quantitative parameters.
- Risk-capital calculation on the basis of a fair value balance sheet: Solvency I is based on national valuation rules and can result in a considerable distortion of competition. Under Solvency II, however, similar risk profiles should result in identical capital requirements. It is therefore urgently necessary that both the capital requirements and the available funds be calculated on the basis of uniform valuation methods. In order to determine the economic capital requirement on the basis of a fair risk assessment, the calculation of the capital requirement must be based on a fair value balance sheet.
- The diversification of risks is an essential component of successful risk management. By taking into consideration diversification effects in the calculation of capital requirements, the future solvency system is to offer incentives for the avoidance of risk concentrations and promote the development of risk management.
- Supervisory authorities' rights and powers of intervention should be subject to the principle of commensurability. Interventions by supervisors must be restricted to what is necessary and appropriate. The principle of commensurability is an achievement of constitutional and administrative law and should not become a victim of the internationalization of supervisory legislation. Reporting obligations of companies, except in crisis situations, should orient themselves on the internal procedures of companies in order to ensure that internal and external reporting are synchronized as far as possible.
- If appropriately implemented, Solvency II will promote healthy competition in the insurance market, creating effective and clear principles for pillars 1 and 2. As far as pillar 3 is concerned, the supervisory authorities should increasingly emphasize transparency as a means of improving market discipline.
- The European supervisory authorities should be encouraged to trust the market mechanisms – instead of rigid rules. Improved transparency with which it would be possible to compare solvency requirements across different jurisdictions is instrumental in re-establishing the trust in the financial soundness of the insurance industry. This trust is a prerequisite for successful and profitable future growth.



VI. Liberalisation of the Exchange of Legal Services

For fair competition and consumer protection:

- elimination of Germany's special role in the field of legal consultation services
- protection of consumer interests
- creation of future-oriented general framework for the legal services market in a united Europe
- creation of greater competition

The efforts made by the European Union to achieve deregulation of the exchange of services and free competition often face national obstacles, as in the case of the German Legal Services Act. So the legal-expenses insurers are calling for action to accomplish EU conformance of this national ruling that still contains restrictions.

German regulations restrict legal-expenses insurers

The German government's amendment bill on the Legal Services Act reduces the monopoly held by lawyers in the field of out-of-court legal consultation but quite deliberately prevents legal-expenses insurers from providing legal consultation services themselves. It is incomprehensible that automobile workshops can provide legal advice in the future whereas legal-expenses insurance companies cannot. This is discrimination against insurers. The accusations repeatedly made, namely that there is a conflict of interests between the insured party and his legal-expenses insurer, are not justifiable. In all other EU countries, legal consultation services are provided by legal-expenses insurers to the satisfaction of all those involved.

Consumers want legal consultation services from insurers

There is no doubt that consumers want legal consultation services from their legal-expenses insurer. A current study shows that some 75% of the German population are in favour of receiving advice from their legal-expenses insurers. This is because many customers do not want to go straight to a lawyer with their legal problems and certainly do not want to go to court. Their own legal-expenses insurance company with its qualified staff can easily give high-quality legal advice in such cases.



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Consumers have a great need for clarification and transparency. By giving advice, legal-expenses insurers can help consumers to remedy their lack of knowledge and lack of certainty. But, unlike in the other European countries, this is not possible in Germany. In some countries, legal-expenses insurers can even represent their customers right up to court proceedings. So there is obviously a need for adjustment here. This opinion is also held by the Association of German Insurers (GDV) and the international federation of legal-expenses insurers RIAD.

EU legislative initiatives should make the legal services market fit for the future

If it had been implemented as originally planned, the liberalisation of cross-frontier legal services in the EU services directive could have opened the door to liberalisation in Germany. However, although the issue of liberalisation of cross-frontier legal services was included in the first draft directive, it was later removed. Thus services relating to law are to remain the domain of national providers and the special German role is reinforced.

The EU Commission calls for more competition-promoting mechanisms for freelance services. So against this background too, the general framework for legal services in Germany should be reviewed and improved.

In other EU regulatory fields, such as legal protection of patents, alternative mediation, small claims, protection of victims of crime, legal aid and motor vehicle liability, the significance of legal-expenses insurance must be perceived more clearly.

Growth through greater competition on the legal services market

The restrictive regulations in Germany hinder growth and the development of an effective legal services market is fettered.

The legal-expenses insurers can and would like to make a positive contribution to uniting Europe. But to do this, they must be in a position to support people all over Europe in legal matters. They must be in a position to enable individuals to gain information about their legal situation quickly, simply and at low cost and to help them gain access to the law.

The overall target must be to create wider scope within the general legal framework so that legal-expenses insurers can offer legal support to both individuals and companies at low cost.



VII. MiFID

Directive 2004 /39 / EC from 21 April 2004 – Markets in Financial Instruments Directive (“MiFID”)

As a framework directive geared towards the member states, the so-called MiFID constitutes the new „basic law“ for the EU securities markets. In comitology, the framework directive adopted in level 1 must be filled in with the technical details in level 2. The European Securities Committee (ESC) and the Committee of European Securities Regulators (CESR) were engaged in an advisory capacity. The implementation deadline for level 1 and level 2 ends on 30 April 2006. Of MiFID’s core contents, it is mainly the areas of pre-trade transparency and best execution that are of considerable importance.

1. Pre-trade transparency

From a German perspective, it is extremely important that the existing closed order book system in stockbroker trading remains in place. This system specifically guarantees extensive investor protection. It was debated whether the order books of the stockbrokers had to be opened. There are a series of important reasons against this.

Pre-trade transparency is also guaranteed in the closed order book system. Before actually fixing prices, the stockbroker informs the market by specifying an indicative price range between the bid and offering prices of which a market price can be established based on the current order book situation. As a result of this information, the investor can make a sound decision to buy or sell.

The system of stockbroker trading with the closed order book as an integral part of the system ensures that short-term order imbalances can be offset due to the fact that the stockbroker can make an entry himself/herself and wait an appropriate length of time before specifying a new indicative price range. The combination of information, the waiting period and the stockbroker’s intervention rules out prices that are not in line with market conditions to be excluded. A short-term order imbalance, particularly in non-highly liquid securities, is largely avoided. In addition, partial executions with correspondingly high fees for the investor are extremely rare in the case of a closed order book. Such control and optimisation of price fixing by the neutral stockbroker would hardly be possible in the case of an open order book as the options mentioned command confidentiality of the order book situation at this stage.



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The protection of private investors especially is mainly ensured by equal treatment of all investor groups. The information to be found in an order book that everyone can view would primarily be used by the “professional” investor equipped with the relevant software while it would be difficult for private investors to be able to make use of this information. This hampers market manipulation through exploitation of the order book situation by the respectively “professional” market participants. In addition, price fixing is monitored by the stock exchange’s trade monitoring office and the stock exchange supervisory authorities of the respective federal state.

For the purposes of investor protection and market integrity, compulsory disclosure of the order book should be abandoned. An all-out opening of the order book would reduce the protection of those private investors who particularly warrant protection in German securities trading.

2. Best execution

The best execution rule of MiFID places the banks under an obligation to transmit their customer orders to the execution venue which guarantees the best possible result for their customers, particularly in terms of the price, the costs and the speed and probability of executing the order. As part of the execution policy, the banks generally have to justify why they choose certain execution venues. This must be reviewed at least once a year. What is important is that the provisions concerning best execution and the execution policy of the banks apply equally to the regulated markets or multi-lateral trading systems as well as to systematic internalisers. Exchange price fixing by the stockbroker must also be recorded, as must the fully-electronic stock exchange price fixing. Only in this way is competition between all marketers in the customer’s interest stimulated.

VIII. IASs/IFRSs

The International Accounting Standards Board (IASB) is planning accounting for SMEs. But according to a survey conducted by DIHK in mid-2005 among SMEs, around 80% of the companies questioned do not want to apply IASs/IFRSs. The disadvantages of IAS/IFRS accounting outweigh the advantages from the point of view of these SMEs. We would like to take this opportunity to present our common position. As part of the increasing relevance of IAS/IFRS international accounting standards, it is of central importance that SMEs do not



have to prepare any additional accounts, fulfil any accounting obligations that are more complicated than to date and also that the determination of taxable income is still fed from the insolvency-saving prudence principle. In the interest of the companies affected, we therefore argue that SMEs must be kept free of IASs/IFRSs and that they ought not to be smothered by additional complicated accounting obligations.

Thus we mainly call for:

1. Restriction of IAS/IFRS application to capital market-oriented companies, i.e. IASs/IFRSs for SMEs only on a voluntary basis:

Small and medium-sized companies (SMEs) should – unlike capital market-oriented companies – be exempt from international accounting in principle. Thus, a distinction should be clearly made in the accounting principles between companies under ownership (SMEs) and capital market-oriented companies. This does not affect the option to also report in accordance with international accounting principles.

2. No additional accounts for SMEs:

„No additional accounts“ means that a single set of accounts prepared for tax and financial reporting purposes must suffice: As many SMEs currently prepare a single set of accounts for reasons of cost, it is economical to combine the accounts. On no account can a binding parallel accounting obligation (IASs/IFRSs and HGB) in addition to accounts for tax purposes be accepted.

3. No complication of matters for SMEs:

There ought to be no rules more complicated than at present to be fulfilled for annual financial statements. For SMEs, application of IAS/IFRS rules means too much effort in terms of bureaucracy. IAS/IFRS rules are constantly being revised, with the result that the new rules would have to be followed. Today, the number of these already exceeds that of the HGB rules by far. Apart from the scope, some rules are so complex that only specialists can apply these with certainty. In addition to the constant burden, conversion would involve high costs for personnel, computer programmes and the external consultation required that cannot be



estimated. It is currently doubtful whether this would result in the benefit hoped for, on the other hand, for the addressees of SME financial statements (credit institutions, suppliers) as a result of improved transparency. The uncertainties arising from subjective value estimates, for example, must be pointed out here. For the purposes of accounts analysis and the customer rating, the account documents previously available from SMEs can generally be seen as adequate; any open questions are usually discussed bilaterally between SMEs or their tax consultants and the addressees of the annual financial statements.

4. IASs/IFRSs not relevant for the determination of taxable income:

The determination of taxable income must still be fed from the insolvency-saving and ownership-safeguarding prudence principle.

5. Specifically no application of IAS 32

IAS 32 destroys equity. By incorporating the IFRS standard IAS 32 into EU law, the equity of partnerships and sole proprietors, for example, as well as the shares of cooperatives are no longer recognised in specific cases and are valued as debt capital. This constitutes a threat to the existence of SMEs. Such a rule is an example of the problems that IASs/IFRSs bring and should be clearly rejected.

The organisations involved agree that IASs/IFRSs for SMEs entail many risks. They call upon the decision-makers to curb the unobstructed extension of IASs/IFRSs to SMEs.



IX. IASB Project Insurances Contracts Phase II

The IASB is currently developing accounting principles that would require insurance contracts to be measured at fair value. The European insurance industry has recently developed and published own principles for the Phase II Insurance Accounting Model established as common ground between leading preparers in Europe.

The European insurance industry is emphasising the need for a long-term solution to accounting for insurance contracts that recognises the drivers underlying our business. The industry principles are based on three overriding goals;

- that the accounting standard should reflect the insurance business model and the way insurers manage risk,
- that the 'asset / liability accounting mismatch' problem inherent in existing IFRS insurance accounting should be addressed,
- that there should be convergence of insurance accounting at a global level.

X. Capital resources for European Asset Management (AM) Groups:

Both the Equity Guidelines (Basel II) and the Markets in Financial Instruments Directive (MiFiD) are not meant to primarily regulate the AM business, but do so indirectly and ultimately result in excessive requirements being made on companies in this sector.

Currently AM enterprises whose (primary) domicile is in the EU are experiencing a competitive disadvantage, because they have to fulfil requirements across the group. By contrast, for AM enterprises domiciled outside of the EU the guidelines only have to be applied to subsidiaries domiciled in the EU.

Thus specific regulations for the AM sector in the EU would be necessary.

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Munich Financial Center Initiative