

EBI – European Banking Institute

Looking for Purpose

Establishing objective-based regulation after
Wirecard

Dr. Lukas Philipp Köhler

Agenda

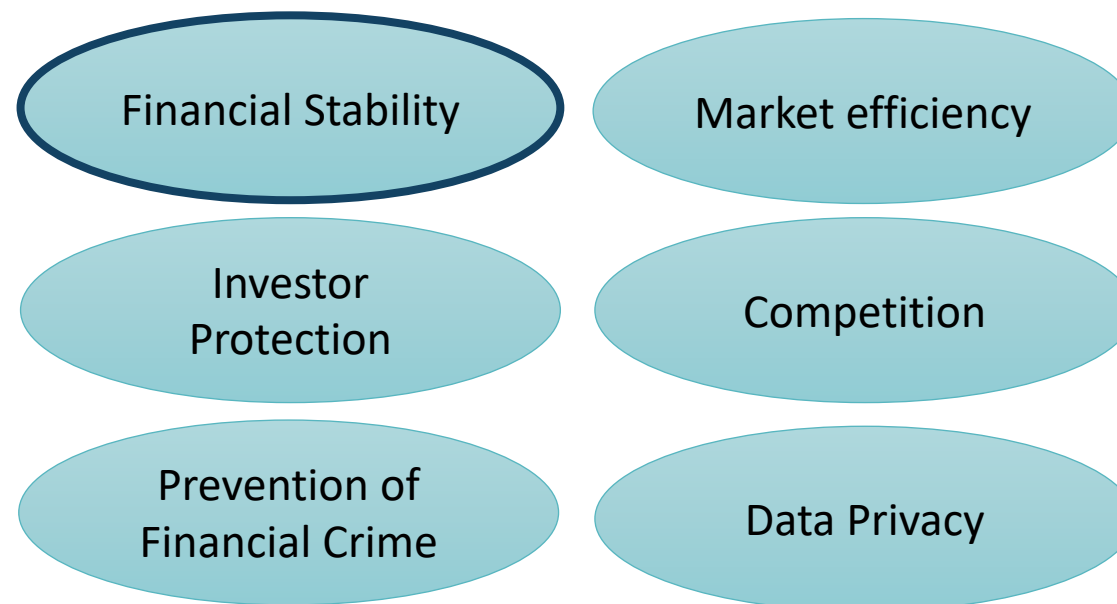
1. **Why do we regulate financial markets?**
2. **How do we regulate?**
3. **What happened at Wirecard?**
4. **Objective-based regulatory setup: Make institutions responsible**

Regulators over financial
sectors



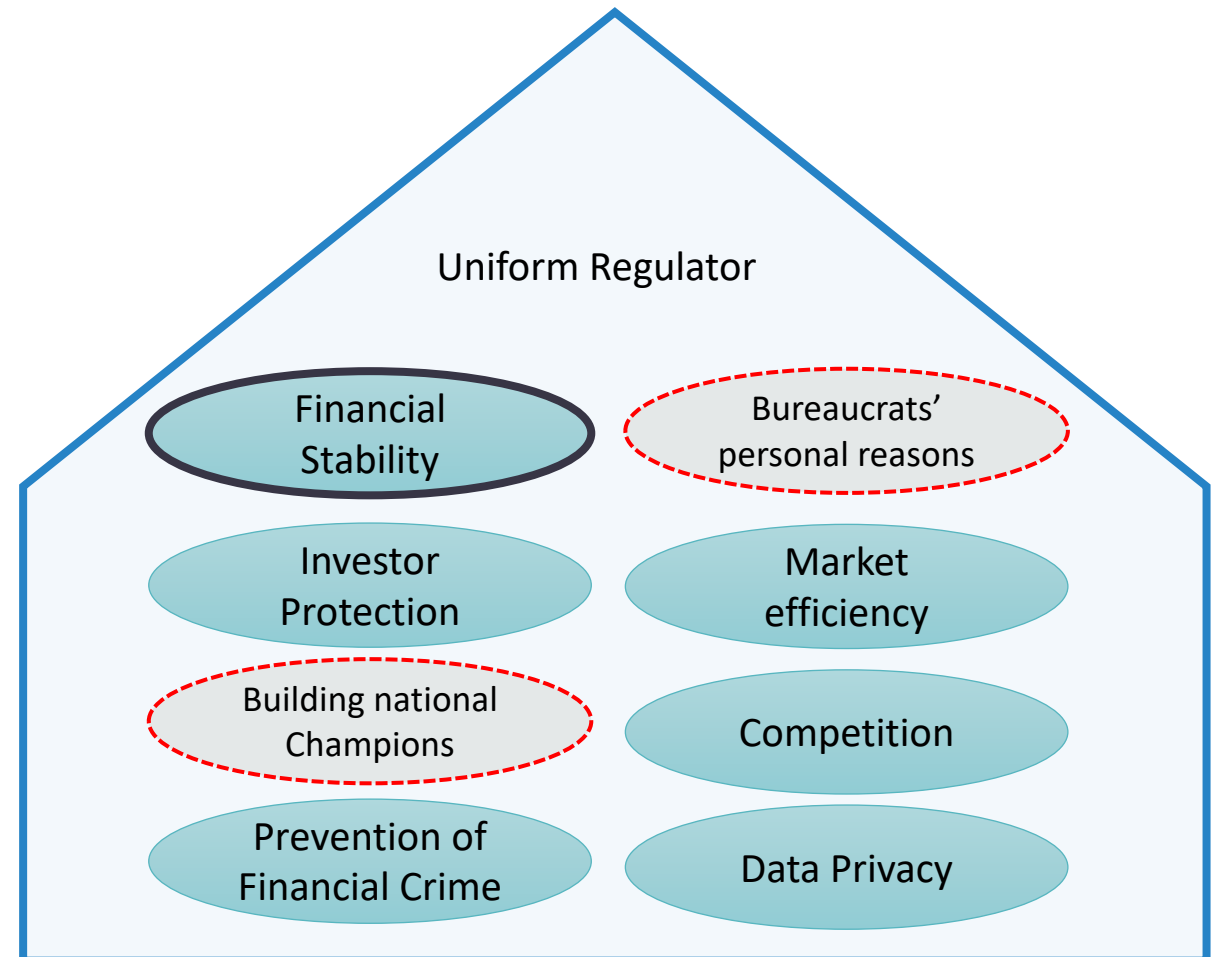
Regulators with specific
objectives

Why do we regulate financial markets?

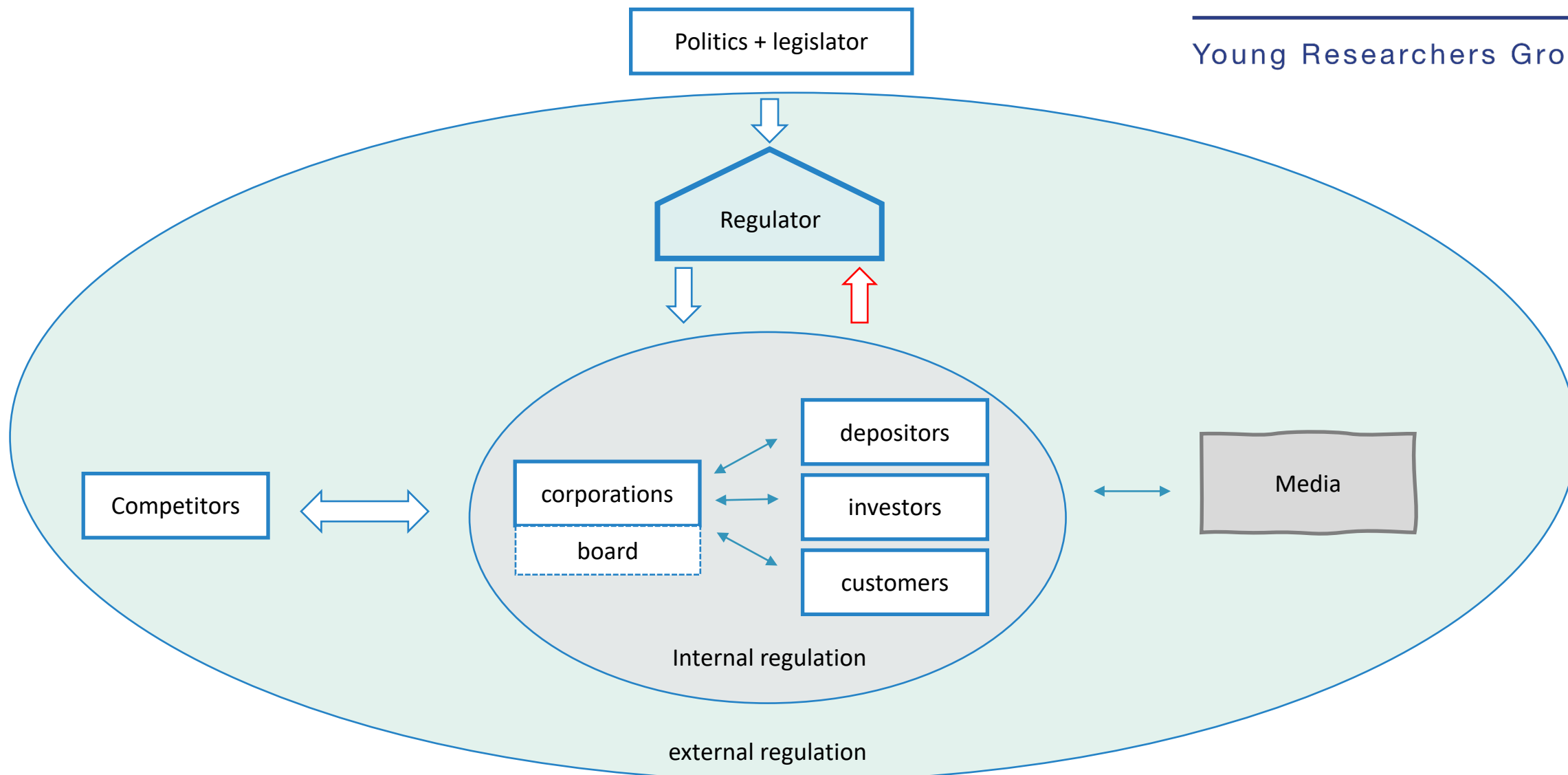


Regulatory agencies are centerpieces for regulatory goals

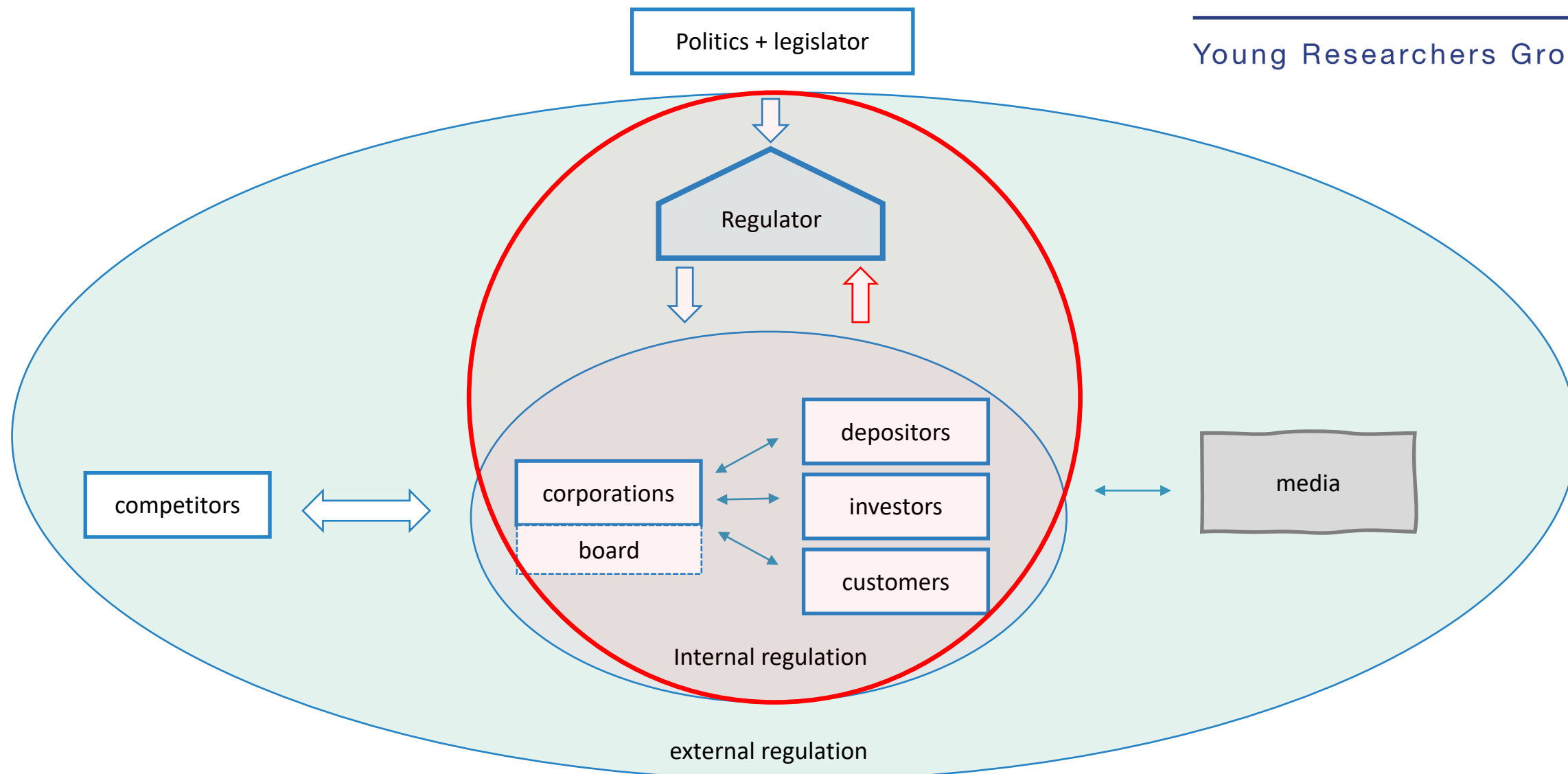
- Regulatory goals may conflict
- Agencies then have to prioritise certain goals over others
 - *internally*
 - vertical hierarchy
- Some goals may even be defined by agency itself for political or bureaucrats' reasons



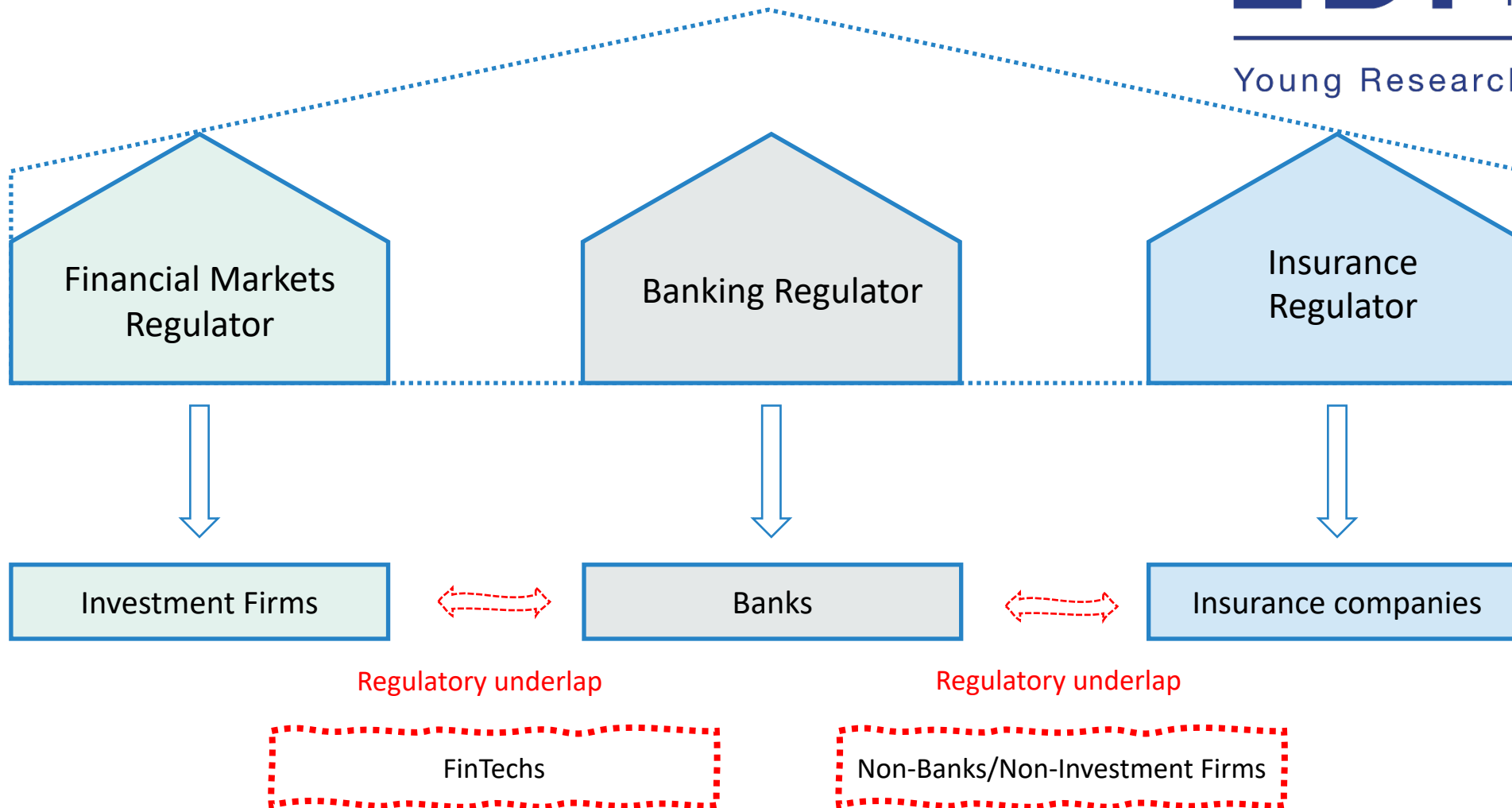
How do we regulate financial markets?



How do we regulate financial markets?



Regulatory agencies are mostly organised sectorally = fixed remits



What happened at Wirecard AG?

2008 –

- € 1.9 billion in assets booked, but didn't exist
- Auditors consulted + signed off accounts of Wirecard AG

- 2015 FT's Dan McCrum investigated re accounting fraud
- reports were suppressed not only by Wirecard AG COO privately and via authorities



2019 – 2020

- No interventions by BaFin re Wirecard AG
 - “Not a bank (financial holding), but Techcompany”
 - only *subsidiary* “Wirecard Bank AG” in regulatory purview
- Accusation: BaFin should have supervised auditor's supervisors But intervention re FT and others:
 - shortselling prohibition
 - prosecutorial investigations
- Politics involved: “national champion”

2020

- 2020: fraud finally uncovered
- BaFin employees (Market Abuse department) traded in shares
- CEO sold shares in the wake of insolvency
- Now in custody
- COO is on the run
- Private lawsuits pending
- Damning ESMA Report on BaFin



This is an issue rooted in fixed, sectoral remits

- Fixed remit: “BaFin is responsible for the regulation of *banks*”
- Based on historical definition by legislators
- Formal definitions, literal construction of regulatory competences allow bureaucrats to hide
 - lack of clear responsibilities
 - lack of motivation to intervene due to *regulatory capture*
 - *home bias* (“national champions”)
 - remember: with fixed remits, regulatory priorities are set *internally* within an agency
- Also, financial institutions know who to capture
- Especially poor performance given dynamism of financial markets and innovative business models

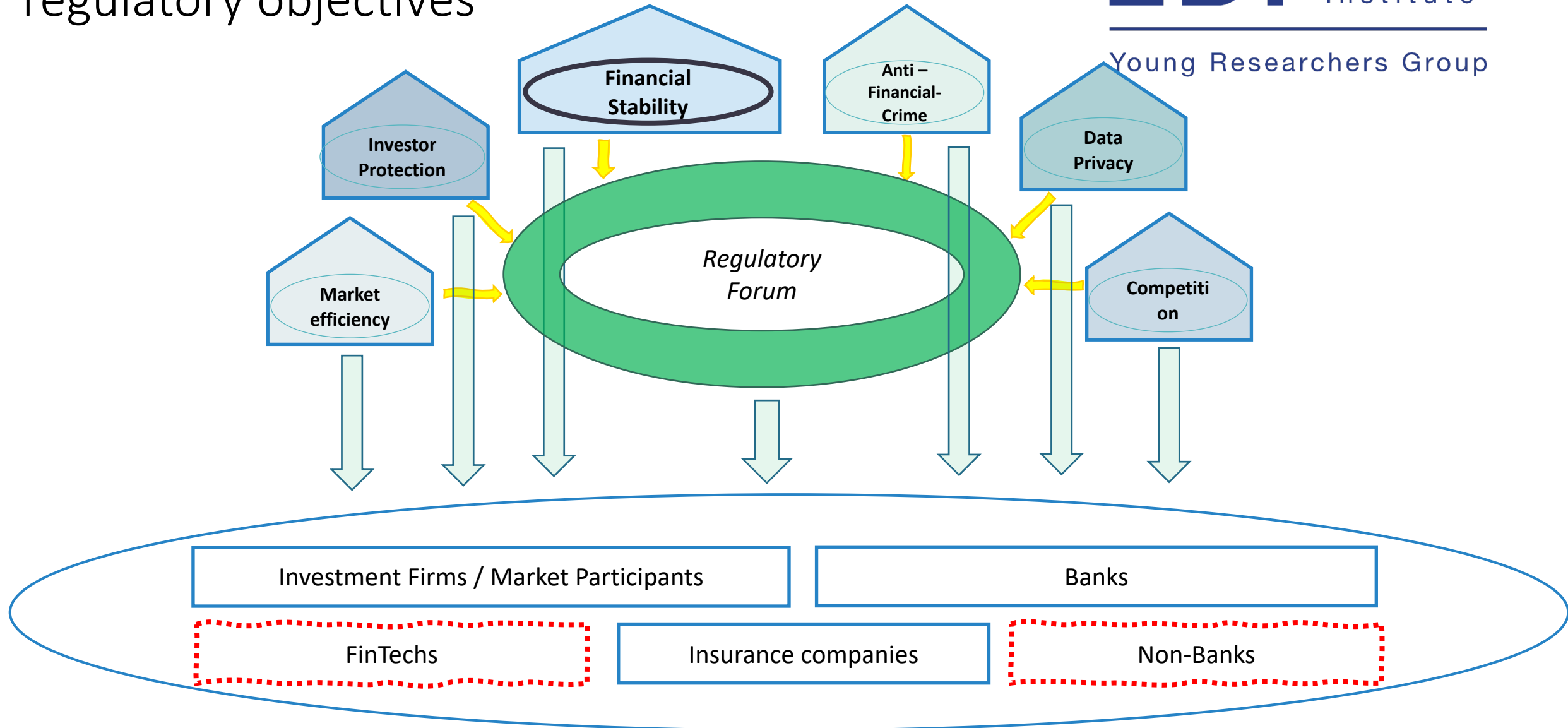
Is it going to be fixed? Ministry of Finance's Action Plan

- Central enforcement
 - improve exchange of information between regulatory agencies
 - reset BaFin
 - Quick intervention rights
 - Special Auditing Rights
- Decentralized enforcement
 - Maybe prohibition of consulting rights for auditors
 - unlimited liability for gross negligence
- Exchange external auditors every ten years
- What about corporate governance?

Solution: Objective-based regulation, flexible remit

- Gear regulators to regulatory goals:
 - “BaFin is responsible for the *protection of financial stability*”
- Nothing new: similar arrangement re police powers
 - “Police may take necessary measures to prevent dangers for public safety and order”
- Regulatory priorities will be set *externally* and within one regulatory agency
- To be sure: regulatory overlaps and disruptions of information flow

A wolfpack of regulators geared towards regulatory objectives



Advantages

- Address financial market's dynamism
 - specialisation + holistic view of risks
 - agency not held back by legislators' historic definitions
 - especially with regards to new business models, digitalisation, maybe crypto?
- Agency Culture and incentives
 - regulatory priorities will be set *externally*, transparent decision-making in regulatory forum
 - Allows regulators to think straightforward
 - regulators' accountability:
 - exert external (public) pressure re certain objectives
 - competition between different regulators
- Lower risk of *regulatory capture*
 - civil servants can neither identify with an industry
 - nor does agency's (budgetary) status depend on the welfare of regulatory subjects

Let's do this



lukas.koehler@ebi-europa.eu

EBI – European Banking Institute

Contact:

European Banking Institute e.V.
TechQuartier (POLLUX)
Platz der Einheit 2
60327 Frankfurt am Main
Germany

Mobil: +49 (0) 173 889 8872
Telefon: +49 (0) 69 7500 3904

E-Mail: www.ebi-europa.eu
Website: <http://www.ebi-europa.eu>