

Introductory statement

ECON presentation of the ESMA Fast Track Peer Review Report on the application of the Guidelines on the enforcement of Financial Information by BaFin and FREP in the context of Wirecard

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Chair

European Securities and Markets Authority (ESMA)

Dear Chairwoman, honourable Members of the Parliament,

I would like to thank you for giving me the opportunity to present ESMA's Fast Track Peer Review Report on the application of the Guidelines on the Enforcement of Financial Information by BaFin and FREP in the context of Wirecard in today's ECON meeting. As you will be aware, the Report was published nearly a month ago, and I will be pleased to guide you through its main elements – including findings and recommendations – as well as answer any questions you may have in relation to ESMA's work on this important matter.

To begin with, I would first like to underline how core to investors' trust in capital markets high quality financial reporting is. And whilst the path to such high quality reporting starts with issuers preparing their financial reports under the applicable framework, and is assured with external audits of those reports, it also involves, as a last line of defence, national competent authorities and their supervision activities in the area of enforcement of financial information.

By way of background, let me recall here that, on 22 June 2020, Wirecard announced that €1.9bn it had claimed to hold in escrow accounts were probably missing. Following this announcement, the European Commission (EC) sent a letter to ESMA on 25 June 2020, inviting ESMA to carry out a fact-finding analysis of the events leading to the collapse of Wirecard and of the supervisory response of the German authorities in the area of financial reporting.

Whilst issues related to other areas of financial market supervision, such as market abuse, short-selling, auditing and corporate governance, may also be relevant in the specific context of Wirecard, ESMA focused its fact-finding work on the supervision and enforcement of financial information in the Federal Republic of Germany under the Transparency Directive

(TD).

In Germany, the enforcement of financial information is performed in a two-tier system where the Financial Reporting Enforcement Panel (FREP) is responsible for examining, in the first tier, whether the information is drawn up in accordance with the relevant reporting framework; and where BaFin is the central competent authority responsible for examinations in the second tier and for taking appropriate measures in case of infringements.

The assessment requested of ESMA was conducted within a compressed timeframe in view of the need to address the situation rapidly. To do this, we were able to make use of the new arrangements of a Fast Track Peer Review, enabled by ESMA's amended founding Regulation which came into force in January this year, and to which this ECON Committee contributed substantially in the preceding years in the context of the ESAs Review. This was also the first Peer Review carried out by ESMA under the new Peer Review Methodology, and the first Peer Review focusing on only one jurisdiction and one market participant. The Peer Review was performed by a Peer Review Committee (PRC) chaired by a senior member of ESMA staff and composed of experts from National Competent Authorities and from ESMA. The report was prepared by the PRC and adopted and approved by ESMA's Board of Supervisors. The Chair of the PRC, my colleague Evert van Walsum, is also present in today's hearing and available to respond to questions you may have.

The peer review tool was chosen as the TD only contains high level principles regarding financial reporting and its supervision, and the IAS Regulation is not included in the list of acts for which ESMA may launch a Breach of Union Law investigation. Considering, firstly, that ESMA developed in 2014, on its own initiative, the Guidelines on the Enforcement of Financial Information (GLEFI) in relation to the TD in order to foster supervisory convergence and, secondly, that a peer review had been carried out on some of its Guidelines in 2017, which had included an assessment of Germany, certain relevant Guidelines of the GLEFI were used as the yardstick for ESMA to carry out the assessment of BaFin and FREP's supervisory actions related to Wirecard. Building on the findings of the 2017 peer review, ESMA also looked into whether there were any legal or other impediments to the efficient functioning of the supervisory set up in Germany.

More specifically, ESMA looked into, in the specific context of Wirecard and over a time span of 2015 to date, the procedures in place at both BaFin and FREP regarding resources, independence and conflict of interests and the selection and examination of issuers as well as the cooperation between the two authorities and, where relevant, with other authorities.

Coming now to the Peer Review findings, a number of deficiencies, inefficiencies and legal and procedural impediments were indeed identified. These relate to the following areas: the independence of BaFin from issuers and government; market monitoring by both BaFin and FREP; examination procedures of FREP; and the effectiveness of the supervisory system in the area of financial reporting. I will now go into more detail for each of these areas.

Whilst the Peer Review did not identify any concerns regarding the adequacy of resources allocated to the Wirecard case by either FREP and BaFin given their respective responsibilities

in the two-tier system, issues were identified in the context of BaFin as regards independence. First, both the frequency and the detail of reporting by BaFin to the Ministry of Finance on Wirecard, in some cases before actions were taken, heighten the risk of influence by the Ministry of Finance on BaFin's actions. Second, as regards independence from issuers, given the lack of information BaFin has on its employees' share holdings, there are doubts regarding the robustness of BaFin's internal control system regarding conflicts of interest of its employees towards issuers under their direct supervision. In this respect, it was noted that Market Abuse team members have been trading Wirecard shares. This is relevant as they provide signals to the team for enforcement of financial information.

As regards market monitoring for the selection of financial reports for examination, it was assessed that FREP did not pick up signals in the international media and failed to select Wirecard for examination in the period between 2016 to 2018 (for financial reports 2015, 2016 or 2017), despite specific risks on Wirecard reporting, which were left unaddressed. In addition, FREP did not recognise the related impact on Wirecard's general risk profile, which, according to their selection model, should have increased the likelihood of Wirecard being selected for examination. At the second tier level, although BaFin is in a different position compared to FREP, BaFin failed to request that FREP examined Wirecard's financial reporting during that same period.

On the other hand, as regards the 2019-2020 selection period (for financial reports 2018 and 2019), FREP and BaFin both appropriately selected Wirecard for examination based on risk.

Coming now to the examinations actually carried out and starting with the examination of the 2014 financial report, deficiencies were first identified in the scoping of the examination where FREP should have focused more on elements material to the business of Wirecard, such as trade receivables and the useful lives of customer relationships. Moreover, FREP should have also been more thorough in examining both media and whistle-blower's allegations when these occurred during the examination by performing and properly documenting additional procedures on the areas highlighted by the allegations and by exercising more professional scepticism.

As for the examination of the 2018 half-year financial report, although the initial scope of examination of BaFin's request to FREP for a focused examination was appropriate, FREP and BaFin should have expanded the scope of the examination to the Third Party Acquiring business (TPA) earlier than October 2019 in view of serious allegations on the existence and volume of TPA revenues, as well as on the lack of related disclosures, being brought up in early 2019. It was also found that by not timely requesting contact with the auditor, the supervisory board, and KPMG, FREP also missed the opportunity to possibly obtain useful and timely information.

Finally, as regards the German supervisory system for financial reporting, a number of impediments to its effectiveness were identified relating to (1) the different perceptions of each institution's respective roles and their limitation in responsibilities regarding cases involving fraud, (2) their high hurdles in terms of substantiation of suspicions of criminal activity to notify the public prosecutor, (3) the high hurdle and the assessment of such high hurdle, in the form

of substantial doubt as to how FREP is carrying out an examination, based on which BaFin may take over an examination from FREP, (4) confidentiality requirements between BaFin and FREP but also towards other authorities preventing efficient exchanges of information and (5) instances of lack of coordination and/or procedural inefficiencies within BaFin leading to the enforcement of financial information team not being aware of relevant media articles and allegations, even if these publications were followed by a significant drop in share price, or of complaints which should have raised red flags about Wirecard's accounting.

The Peer Review provides recommendations to address these shortcomings, which will be followed up, taking into consideration how the supervisory set up in Germany, which is currently under review, will evolve.

Before I address potential next steps, I need to repeat that we have looked at one country and one specific case, in line with the invitation from the Commission. This means that we should be careful in broadening these findings to draw overall conclusions, be it either for the German system as a whole or even for the European supervisory set ups set out in the TD. On the other hand, it is fair to say that this case has, to some extent, 'stress-tested' the German supervisory system. This is evidenced, in particular, by the legal and procedural impediments identified in the report which prevented an efficient and effective handling of the case.

In that sense, ESMA's Board of Supervisors will be considering whether some of the recommendations proposed in the report would be useful in improving the effectiveness of the set up for all examinations and if so, how these could be proposed to be included in EU legislation or result in further, and more effective, supervisory convergence actions.

Beyond the considerations of the financial reporting framework that I just outlined, I would like to offer you also my first assessment of the functioning of ESMA's new peer review arrangements, and in particular the corresponding governance aspects. Indeed, thanks to the legislative amendments brought about by the ESAs review regarding the organisation of peer reviews, which are now led by an ESMA senior staff member, and the strengthening of the independence of ESMA's decision making, I believe we managed to achieve an objective, technical and independent assessment of national supervision in this particular case.

To conclude, I would like to thank you for your interest in ESMA's work and continued support for its role regarding ensuring market integrity, investor protection and financial stability across the EU.

I look forward to answering any questions you may have.