Public Hearing on Wirecard and Lessons Learnt ECON/JURI
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Thank you very much for inviting me to today's hearing on the Wirecard scandal and its implications for the architecture of regulatory oversight in Europe.

In this preliminary statement I would like to
• *first*, remind you of some specificities of the German institutional regulatory design,
• *second*, share some observations on the failure of almost all monitoring agents, and
• *third*, comment on proposals of how to move forward.

When allocating blame for the Wirecard scandal, most fingers have been pointed to BaFin, the German supervisory agency, a number of people have resigned since then and, as we learnt yesterday, a new head has been chosen. To add some context, I would like to give a quick overview on the German regulatory design. There is one clear institutional design flaw in the German regulatory architecture which a new law is going to fix. Aiming at combining the best of two worlds, Germany has had a private („financial reporting enforcement panel" FREP) and a public (BaFin) body in charge of supervising financial reporting. The design flaw had to do with how these two bodies interacted: During the time the private body was investigating potential concerns, the public body had almost no jurisdiction in the matter. On top of that, the private body is small and had in the past focused more on details of accounting law, rather than large-scale corporate fraud investigations. Additionally, it lacked enforcement rights, in other words: was based on cooperation by the investigated company. Lastly, BaFin, which is in charge not only of financial reporting supervision, but additionally of capital markets supervision and of banking supervision, does not enjoy the status of an independent regulatory agency. Instead, BaFin reports to the Ministry of Finance, a fact which has led to much speculation about the government insisting on preferential treatment for Wirecard. Let me add, however, that this form of embeddedness of BaFin into the Ministry has been understood against constraints of German constitutional law. Under the relevant reading of the Constitution, the principle of democracy requires a public agency to be able to trace its powers back to the government. Put differently: a truly independent public agency is a rare exception under German constitutional law.

In Wirecard, we are looking not only at a failure of supervisory agencies. Private bodies have not performed better. As to shareholders, neither institutionals nor activists have raised red flags. The same is true for almost all outside creditors, especially for banks which had credit lines open with Wirecard. The auditing company did not seem to have caught the fraud either. This holds important lessons for classic corporate governance research and lawmaking which has for decades focused on the incentives of precisely those (private) monitoring agents I have just listed. Take the shareholder rights Directive as an example, which has in the wake of the financial crisis and following the idea of shareholder stewardship tried to motivate institutional investors to engage more in corporate governance. At least as far as corporate fraud is concerned, these do not seem to be the core, maybe not even the relevant players. Instead, the only successful monitors are actors few corporate governance scholars have focused on so far: Journalists, some whistleblowers, and short sellers.

This brings me to some proposals on how to move forward. Before delving into the details, let me stress one key observation. While Wirecard has revealed major weaknesses in the oversight regime, it is not so much that we are missing one or two key pieces which we could introduce and then move on, as it were. Mostly, we are not looking at a lack of applicable legal rules but at a lack of enforcement. Hence, when considering how to react to the scandal, it seems to me that strengthening accountability is a core issue. Of course, how to achieve better accountability, to incentivise agents to „take charge", step in and enforce, will vary, depending on the actors we are considering, especially whether they are public or private bodies. Complicatedly, there are not only elements of institutional design and legal framework to consider, but, in my opinion, culture and a number of national

behavioral biases play an important role, too, and a number of proposals I shall make address precisely this point.

In my very personal „hitlist" of proposals to move forward after Wirecard, institutional design of regulatory bodies is of prime importance. This has implications for both, Germany and the EU.

- As to Germany, we have yesterday published a policy paper making a case for an independent BaFin, insulating the agency from the Ministry of Finance. While we appreciate the concerns of German constitutional law which I have touched upon earlier, we submit that capital markets oversight presents a good case for putting an end to the reporting lines between the Ministry and BaFin without violating principles of democracy.
- As to the EU, we have in our study for ECON insisted on moving further with plans to build a European body to supervise capital markets. We believe that this helps to avoid supervisory fragmentation, reduce home bias in supervision, curb regulatory capture and build a strong common capital markets culture. Needless to say, after Brexit the need for one central counterpart has become ever more salient. In the context of my work for the High Level Forum on the CMU, I found proposals of a hub-and-spoke architecture especially convincing. These rest on the idea of preserving national supervisory agencies as competent authorities, and having them report to a single EU hub. Much of what has worked very well for the Banking Union might provide useful in this context.

Moving further down in my „hitlist", I have a number of more granular suggestions as to what might be lessons learnt from Wirecard, considering which actors were successfully contributing to uncovering the scandal.

- Short sellers have proven to provide precisely the type of useful negative information on issuers which capital markets research claims they do. Against this background, BaFin's decision to issue (its first ever) short sale ban and ESMA's positive opinion on this ban clearly sent the wrong signals. At the same time, this provides a good example for my claim that it is not a lack of rules but a deficiency in accountability and enforcement culture which we are looking at. Anecdotal evidence after both, the financial crisis and the COVID pandemic, suggests that many countries seem to fall prey to the temptation of issuing short sale bans for more political than economic reasons. Hence, moving forward we might need to include (even more) behavioral and cultural training at regulatory agencies and push for EU supervisory teams of a mix of nationalities. In an ideal world, this would reach beyond the EU to establish (more) formats of conversation with UK, US and Asian supervisory agencies.
- Whistleblowers seem to have played a role at both, Wirecard and the auditing company E&Y. With the Whistleblowing Directive, the EU has taken an important first step towards better protection for whistleblowers. At the same time, it seems to me that, again, national culture has hindered a more forceful approach to whistleblowing, for instance as far as financial incentives or requirements to follow up on anonymous whistleblowers are concerned. It is my hope that national legislators, when transposing the Directive, will include more elements of this type. Similarly, EU authorities should give the question of incentives for whistleblowers, rather than protection only, more consideration.
- Concluding with more traditional issues of good corporate governance, we will need to continue working on setting incentives to monitor and on pushing for accountability, even if Wirecard has, once again, proven that we are looking at an uphill struggle. Good boards will have to be diverse and include a considerable number of independent members. We need a maximum number of years on the board, staggered boards and mandatory specialised sub-committees. Liability for board members in supervisory positions has to be very clearly spelled out at EU level and not be relegated to details of national corporate law.

Thank you very much for the chance to offer these preliminary remarks, I am looking forward to discussing them in more detail.