

The Role of the Federal Financial Supervisory Authority (BaFin) in Financial Consumer Protection

Ursula Gerold BaFin, *International Consumer Protection*

- I. Introduction: Background and Organisational Structure
- II. BaFin's Role in European and International Financial Consumer Protection (FCP)
- III. The Consumer Protection Department: Structure and Tasks
- IV. Selected Examples for Supervision and Enforcement in Retail Financial Services in Practice

I. Introduction

1. In a Nutshell – BaFin's Core Tasks

BaFin is the integrated supervisory authority for Germany's financial market.

As an integrated financial supervisor BaFin supervises securities trading and various financial institutions such as

- credit and financial services institutions (*together with Deutsche Bundesbank and the European Central Bank (SSM)*),
- insurance undertakings,
- pension funds,
- payment institutions,
- asset management companies and
- deposit-guarantee schemes.

→ BaFin's objective is to ensure the proper functioning, stability and integrity of the German financial system.

I. Introduction

2. The political accelerator: PROKON

- Prokon was a firm investing in wind farm projects
 - It raised 1.4 billion euros by selling **profit-participation certificates**
 - offered high interest payments - through advertising on prime-time German television and mass mailings
 - approximately 75000 participation rights owners, mainly retail investors
 - with profit-participation certificates, the investor also participates in losses; unlike shares, the securities do not give holders any say in the company
 - Consumer groups accused Prokon of attracting investors with promises of potential returns of at least 6 percent a year without giving sufficient warning of the risks
- Prokon filed for insolvency in January 2014 after a growing number of stakeholders asked for their money back following media reports about the business

I. Introduction

3. Retail Investor Protection Act



Retail Investor Protection Act ("*Kleinanlegerschutzgesetz*")

- entered into force on **10 July 2015**
- introduced **explicit overarching consumer protection mandate** in BaFin's founding act (*Act Establishing the Federal Financial Supervisory Authority – FinDAG*):

Section 4 FinDAG – *Functions and cooperation*

(1a) ¹*The Supervisory Authority is also responsible, within the scope of its legal mandate, for protecting the collective interests of consumers. [...]*

I. Introduction

5. Collective Consumer Protection

“Collective consumer protection”

- BaFin protects consumers as a whole and therefore does not assist individual customers of financial services providers

two exceptions:

- Arbitration Board for consumer disputes in relation to provisions pursuant to the German Investment Code (*Kapitalanlagegesetzbuch – KAGB*)
- disputes in relation to the Basis bank account under the German Payment Accounts Act (*Zahlungskontengesetz – ZKG*)²

I. Introduction

5. Changes in BaFin's Organisational Structure

General organizational overhaul as of 1 January 2016 reflecting i.a. BaFin's new mandate for collective consumer protection

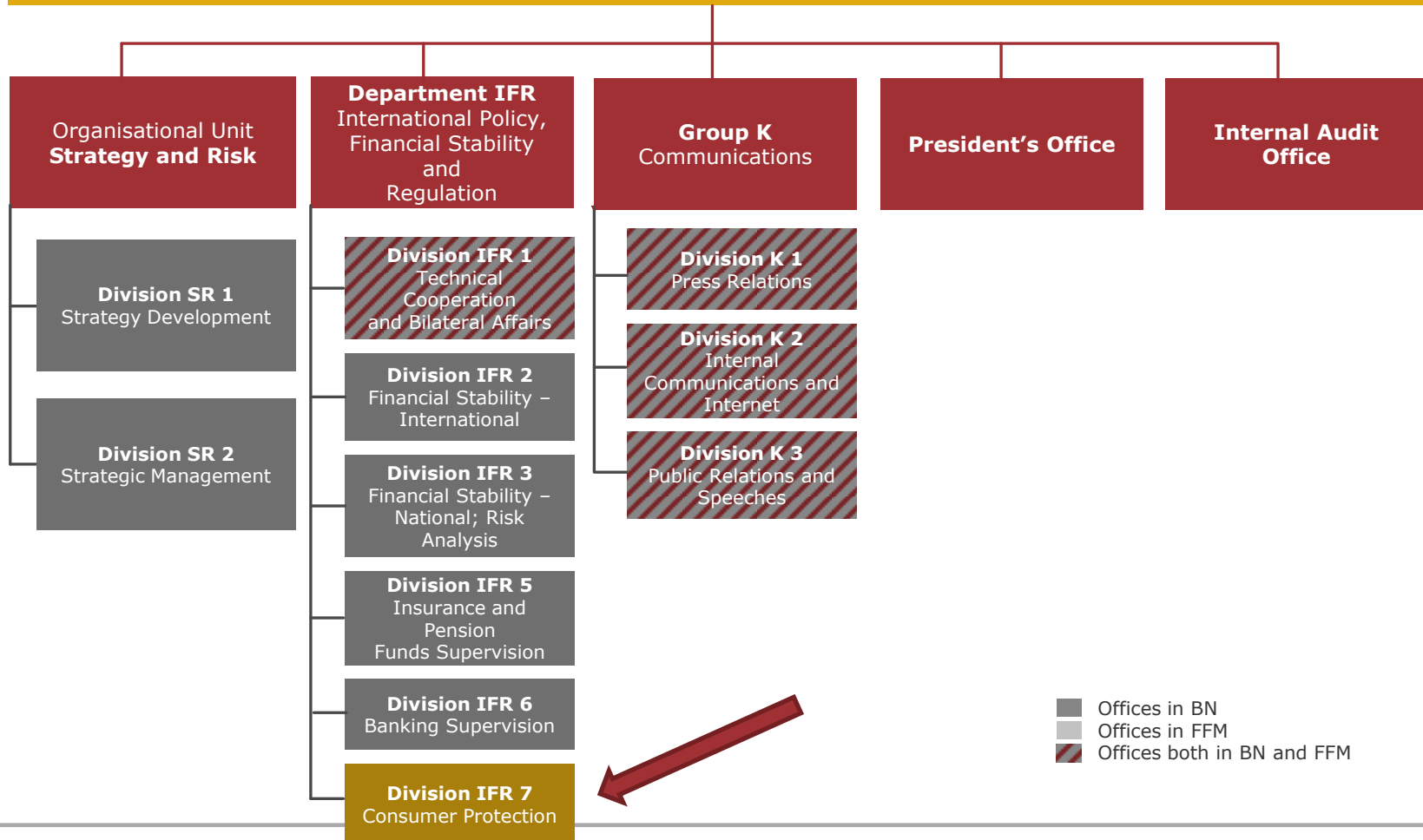
Theses changes include:

1. Establishment of a dedicated **Division for International Consumer Protection**
2. Establishment of a new **Consumer Protection Department**

I. Introduction

5. BaFin's Organisational Structure

Presidential Directorate



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II. BaFin's Role in European and International FCP

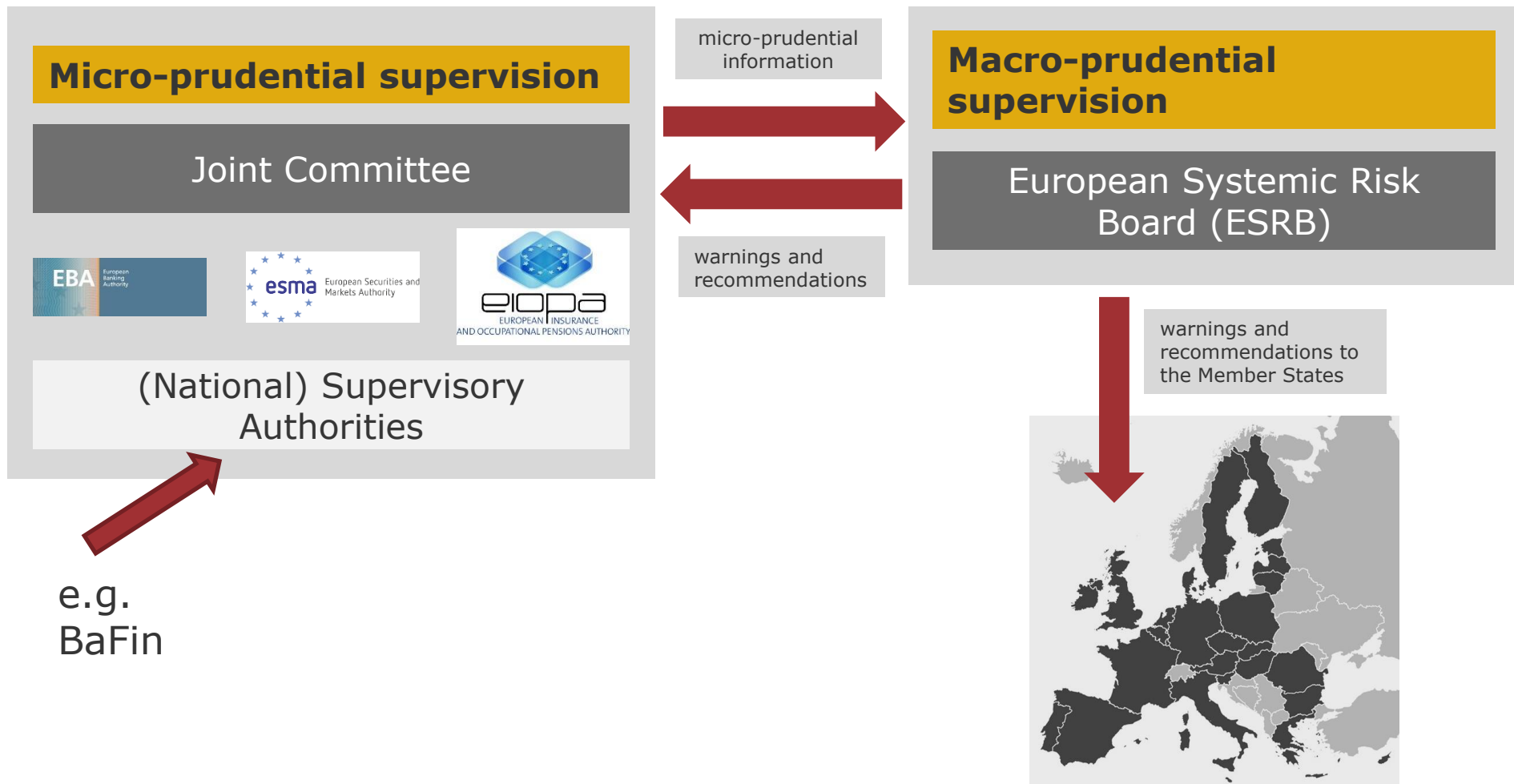
1. *Main Tasks of IFR 7*

Division IFR 7:

- represents BaFin in **European and International** working groups that deal with FCP issues
- has cross-sectoral competency (banking, insurance and securities area)
- develops BaFin positions on FCP issues
- works on core issues related to international FCP

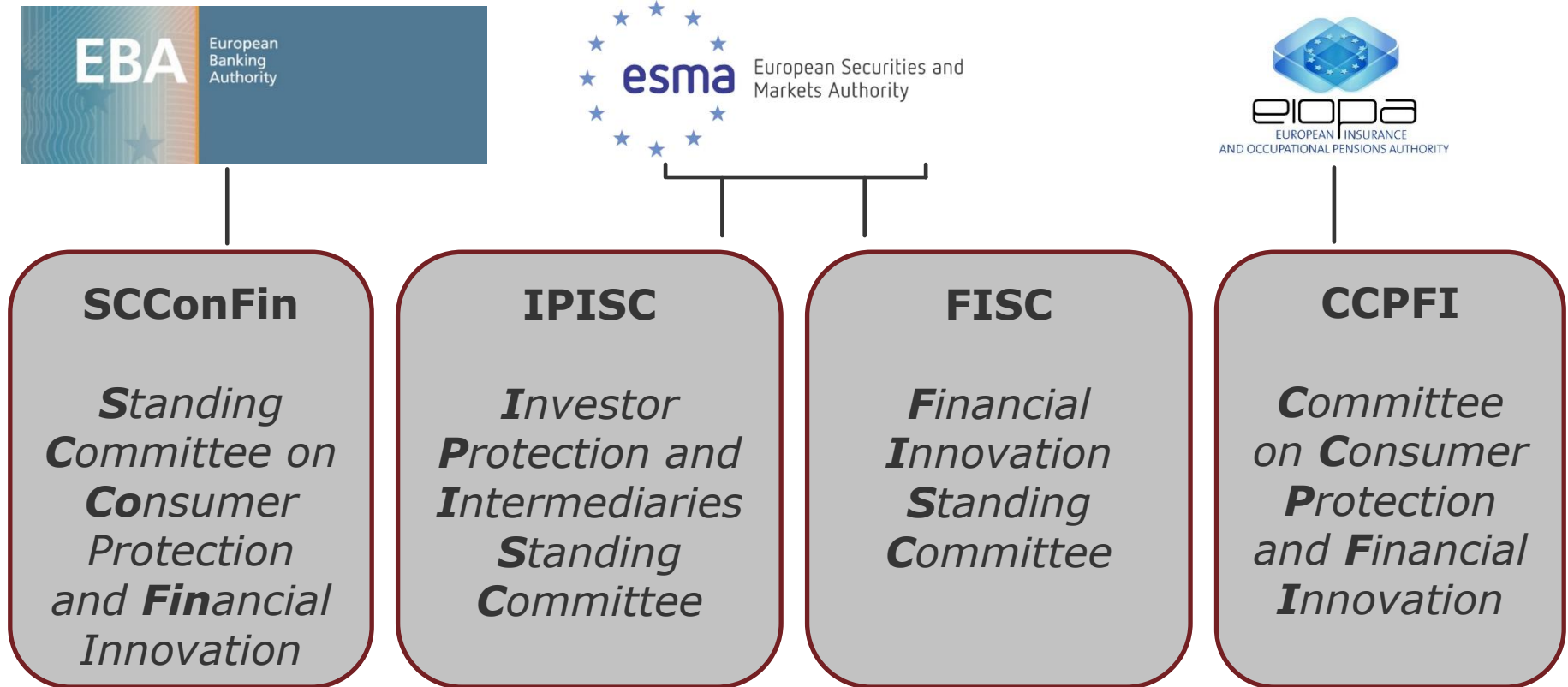
II. BaFin's Role in European FCP

2. European System of Financial Supervision (ESFS)



II. BaFin's Role in European FCP

4. ESA's Consumer Protection Committees

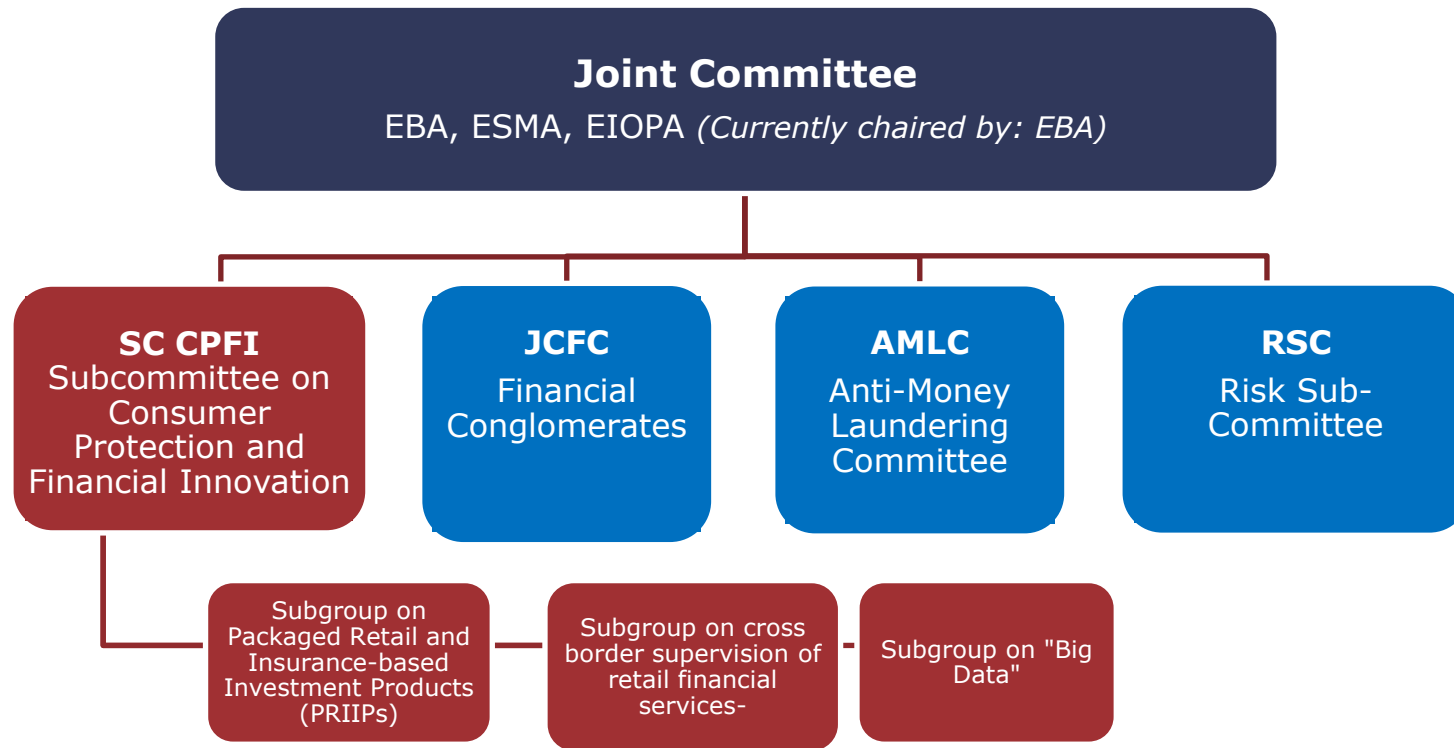


II. BaFin's Role in European FCP

5. Joint Committee (of the ESAs)



JOINT COMMITTEE OF THE EUROPEAN
SUPERVISORY AUTHORITIES



II. BaFin's Role in International FCP

6. International Standard-Setting Bodies



IAIS – International Association of Insurance Supervisors

„Market Conduct Working Group“



IOSCO – International Organization of Securities Commissions

„Committee on Regulation of Market Intermediaries (C 3)“

„Committee on Retail Investors (C 8)“

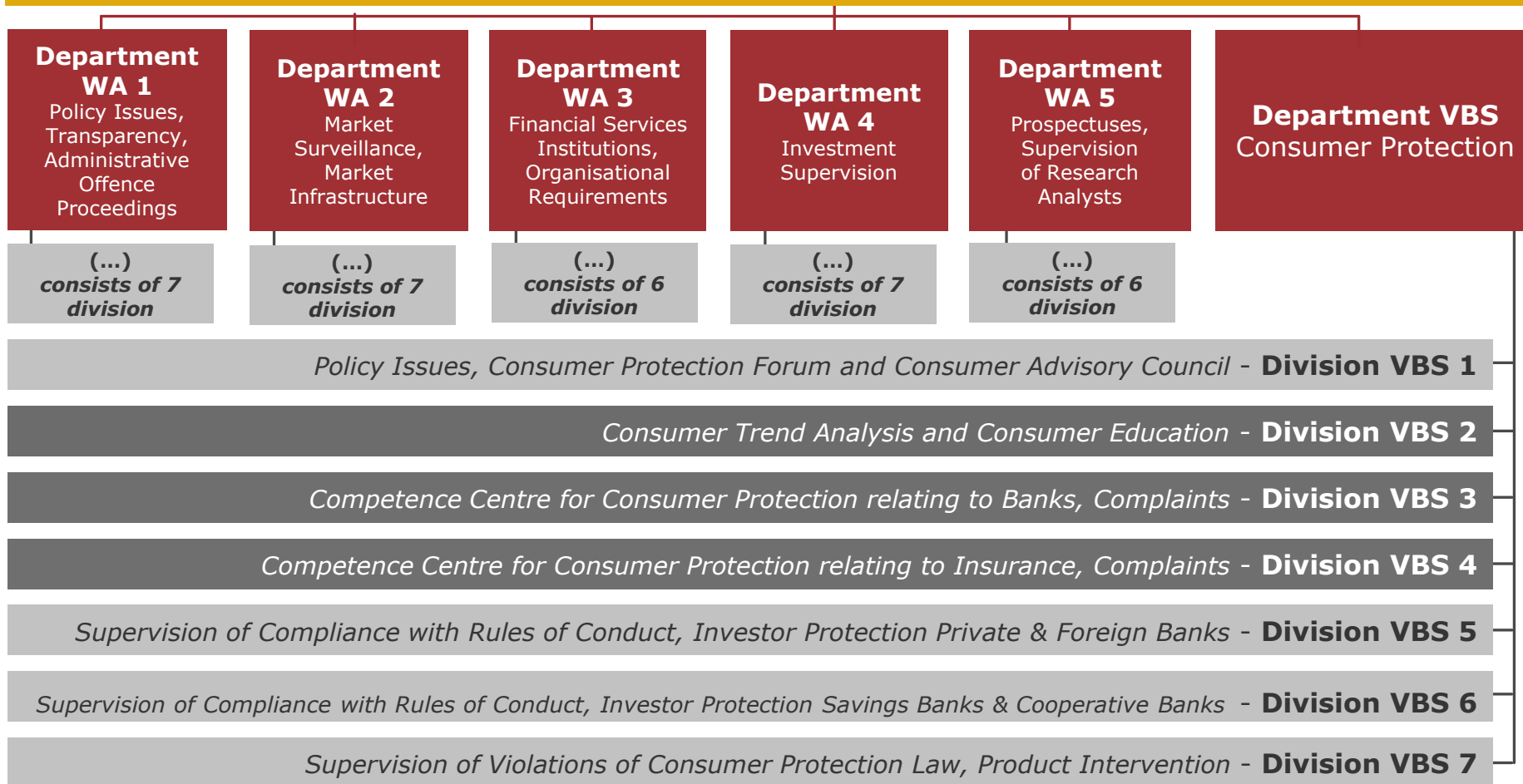
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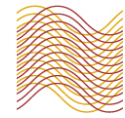
III. The Consumer Protection Department

3. Structure



Securities Supervision/Asset Management

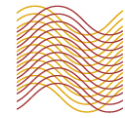




III. The Consumer Protection Department

5. The Elements of Consumer Protection

- BaFin supervises compliance with rules of conduct at banks, savings banks and cooperative banks in accordance with the German Securities Trading Act (Wertpapierhandelsgesetz - WpHG)
- BaFin can issue orders to institutions and other companies that are subject to supervision in order to prevent or remedy irregularities it has found (e.g. in the examination of a complaint)
- as part of its investor protection mandate, BaFin also seeks to prevent unauthorised financial business



III. The Consumer Protection Department

5. The Elements of Consumer Protection

- BaFin methodically gathers, **analyses** and evaluates **qualitative and quantitative information** about market activities from internal sources (e.g. consumer complaints) and external sources and **performs risk-orientated investigations** in order to identify developments which could result in risks or irregularities
- BaFin can restrict or fully prohibit certain sales practices and the sale of products in serious cases – specifically, if investor protection or the functioning or integrity of the financial markets is jeopardised (“**product intervention**”)

III. The Consumer Protection Department

5. The Elements of Consumer Protection

- BaFin endeavours to ensure that the range of financial **products**, insurance products and financial **services** on offer is **transparent** and **comprehensible**
- BaFin provides general consumer **education** about the different types of financial products, insurance products and financial services as well as the risks associated with them.
- protection of individual interests lies within the remit of ombudsman services, dispute resolution entities, consumer organisations and civil justice

III. The Consumer Protection Department

5. The Elements of Consumer Protection



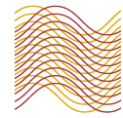
- The consumer protection department serves as a **point of contact** for different organisation and other third parties, e.g.:
 - Financial market watchdogs of consumer organisations (*Marktwächter Finanzen*)
 - Office for the Prevention of Unfair Competition (*Wettbewerbszentrale*)
 - Consumer Protection Forum (*Verbraucherschutzforum*)
 - BaFin's Consumer Advisory Council (*Verbraucherbeirat*)
 - the different Ombudmen (banking, insurance, intermediaries)

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IV. Selected Examples for Supervision and Enforcement in Retail Financial Services



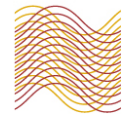
1. Employee and Complaints Register (*Mitarbeiter- und Beschwerderegister*)
2. Market Monitoring
3. Product Intervention
4. Supervision of Product Information



IV. Examples for Supervision/Enforcement

1. Employee and Complaints Register

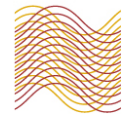
- The Employee and Complaints Register (*Mitarbeiter- und Beschwerderegister*) was introduced in **2012** and is maintained by BaFin.
- Undertakings which provide investment services are required to enter their **investment advisers, sales officers** and **compliance officers** into the Register before the person starts its service.
- These persons must satisfy certain **minimum requirements** with regard to **knowledge** and **reliability**.
- BaFin receives **reports** whenever retail clients **complain about investment advice** they have received.



IV. Examples for Supervision/Enforcement

1. Employee and Complaints Register

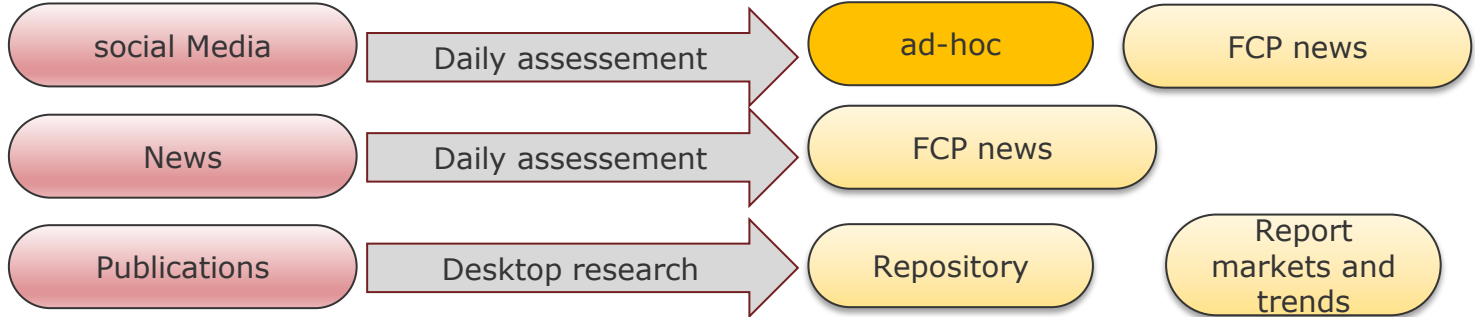
- As at 30 June 2016 more than **152,000 employees**, including almost 145,000 investment advisers, were registered
- From the start of the register in November 2012 until end of June 2016 almost **25,000 complaints** have been reported
- **BaFin regularly evaluates the complaints** entered into the register as complaints may serve as an indicator of irregularities
- The knowledge gained from the Register (together with other operational supervision activities) may result in **formal warnings** and proceedings for the imposition of **administrative fines**.
- The Register has proved to be a useful supervisory tool and has become a corner stone of BaFin's risk-based supervision
- It also has preventive effects



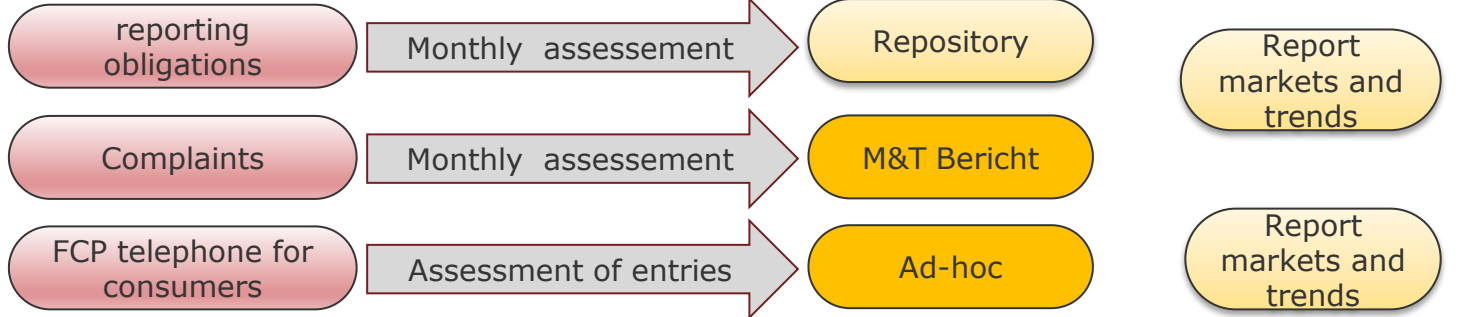
IV. Examples for Supervision/Enforcement

2. Market Monitoring

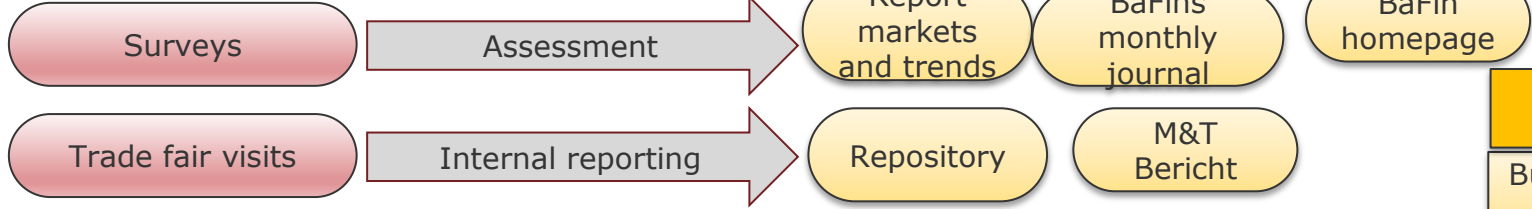
▪ **From public sources**



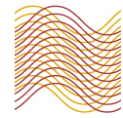
▪ **BaFin internal sources**



▪ **new sources**



| |
|------------------------------|
| Early warning system |
| Building up market knowledge |



IV. Examples for Supervision/Enforcement

3. Product Intervention

a) The CLN case (Credit Linked Note)

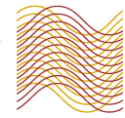
- In 2016 BaFin intended to prohibit the marketing, distribution and sale of credit-linked notes (CLN) to retail clients

BaFin's significant investor protection concerns in relation to CLN are based particularly on

- the high degree of **complexity** of the products
- the risk that a **conflict of interest** is inherent in the product structure
- the (German) product **name** is **misleading**

→ Industry reacted by means of self-commitment for the issue and distribution of credit-linked notes

→ BaFin temporarily suspended its planned ban and is currently re-assessing the market situation



IV. Examples for Supervision/Enforcement

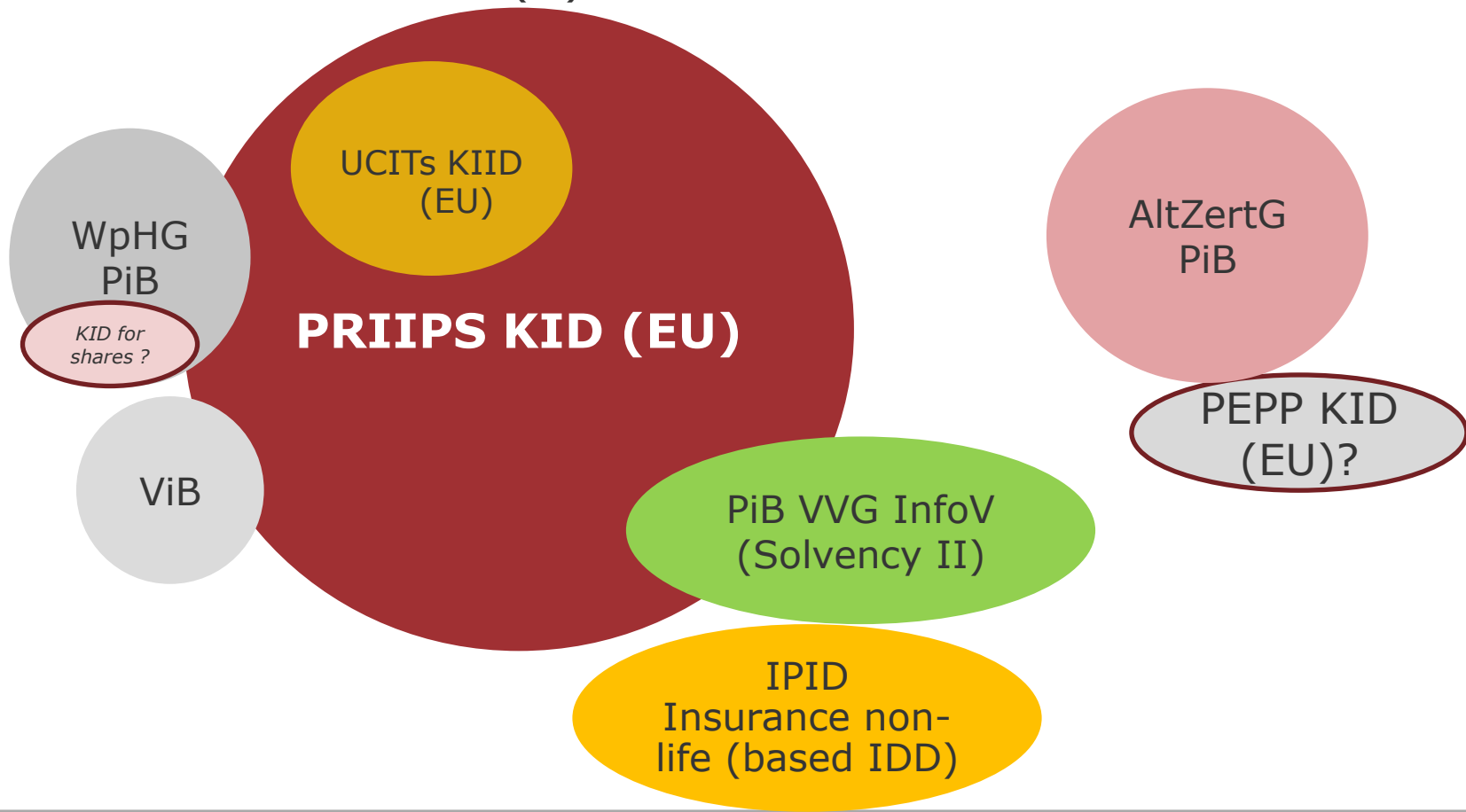
3. Product Intervention

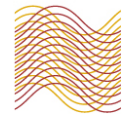
- b) The CFDs case (Contracts For Differences)
 - CfDs sold to retail customer often contained additional payment obligations
 - CFDs are short term leveraged contracts characterised by a high risk of loss
 - Market studies revealed that CFDs providers specifically target retail client whereas the vast majority of them loose money
 - Consumer collective interests outweigh commercial interests
 - In May 2017 BaFin has restricted the marketing, distribution and sale of CFDs to retail clients insofar as they may give rise to an additional payments obligation

IV. Examples for Supervision/Enforcement

5. Supervision of Product Information

Aim: Investment (+)Insurance Retirement





IV. Examples for Supervision/Enforcement

5. Supervision of Product Information

- Starting in 2018: BaFin` as competent authority for the PRIIPs Regulation
- Powers for intervention and sanctions where a PRIIP manufacturer
 - Fails to provide clients with a KID
 - is not compliant with legally binding KID requirements
- Risk based PRIIPS KID supervision combating malpractice
- No pre-notification for PRIIPs KID planned
- Close co-operation with NCAS within EU/EEA
- Convergence of administrative practices in the EU in order to prevent market hurdles

*Thank you very much for your
attention!*

Questions?