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Cum-Ex trading scandal in Germany - A huge challenge for financial institutions and the insurance industry

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In Germany, following the financial crisis, scandals involving banks and financial institutions have almost become common place. However, the latest scandal to emerge, involving so-called “Cum-Ex” deals, is threatening to overshadow all previous controversies in terms of the sums involved and the number of banks implicated.

It is reported that up 100 banks are under investigation by the German authorities in relation to “Cum-Ex” deals. These deals involve illicit tax refunds which may have cost the German State up to €12 billion.

The German authorities are investigating allegedly tax-driven share transactions, which took place around the dividend record date, which were allegedly executed by banks between 2001 and 2011 trading on their own account or on behalf of third parties. “Cum-Ex” trades involved the acquisition of shares with (cum) dividends due on or just before the dividend record date and delivery of these shares after the dividend record date without (ex) dividends, which made it possible to obtain multiple returns of capital gains tax that had only been paid to the German tax authorities once. The authorities are also investigating “Cum-Cum” deals, which involved the short-term transfer / loan of shares owned by a foreign company or investors to a domestic German bank, which subsequently applied for a tax refund on the dividend, which would not have been available to the foreign company / investor.

“Cum-Ex” trading was formally prohibited in Germany in 2012, but the German tax authorities are looking at the trades before this date to determine if the practices engaged in by the banks constituted tax evasion. The authorities are also examining the roles of various accountancy firms and law firms who were involved in the development of the tax-models which were used.

The investigation in Germany is politically charged with a number of state-owned banks involved in the investigations. The investigation is now also receiving significant publicity in Germany. A parliamentary enquiry committee of the German Bundestag has been established to investigate the scandal. The committee has interviewed a number of bank CEOs and also politicians about their roles in the scandal. In addition, public prosecution departments in Germany have recently acquired data storage devices with transaction data of a number of German banks. This has given fresh impetus to the “Cum-Ex” investigations and has resulted in numerous new preliminary investigations being commenced by the authorities.

As indicated above, approximately 100 banks (both German and international) have been the subject of the investigations. The institutes that were particularly in public focus last year were private banks Sarasin and Warburg, international banks UniCredit/HypoVereinsbank and Commerzbank, state-owned banks WestLB and HSH-Nordbank and also the European branch of Canadian Maple-Bank which was forced to file for bankruptcy as a consequence of the scandal. It is safe to say, however, that virtually all the major banks in Germany have been implicated in one way or another. The list of those involved reads like a “Who’s who” of the banking sector.

The scandal is likely to have significant financial impact. As stated above, Maple Bank has already filed for bankruptcy as a result. On the basis that the authorities are treating the “Cum-Ex” trades as tax evasion, this potentially allows them to go back 10 years and seek financial recourse in respect of profits previously deemed secure and closed. The ongoing investigations are at various stages. Some banks (e.g. Commerzbank) are engaged with the tax authorities about repaying tax refunds. Others are, however, still in the process of carrying out internal investigations or are dealing with preliminary proceedings issued by public prosecutor's offices (e.g. WestLB). It is clear that the scandal will continue to rumble on for some considerable time.

Whilst the scandal has clear implications for the banks and financial institutions involved, there are also far reaching consequences for their D&O insurers. At the end of last year, UniCredit/HypoVereinsbank brought claims for damages amounting to €140m against three former board members for their role in shaping the bank’s policy on “Cum-Ex” trading. It seems inevitable that similar claims by other banks and institutions will follow in due course as the investigations and scandal unfold further. This is therefore an issue which is likely to be the focus of attention for D&O insurers for some time to come.

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