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German regulator shamed by fraud allegation

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BaFin, Germany's chief financial regulator, has suffered an embarrassing multi-million euro fraud, allegedly masterminded by a senior manager, triggering *Schadenfreude* among the financial community and criticism from government representatives.

State prosecutors in Bonn said on Wednesday that BaFin's head of IT had been arrested on charges of corruption and breach of fiduciary duty. A secretary and a friend from outside the regulator are also being investigated on suspicion they conspired in the fraud, using the outsider's consulting firm to launder at least €2.6m of false bills.

Although the affair has no bearing on BaFin's core regulatory work, the fact that a senior manager was apparently able to divert funds for more than two years has been criticised in the financial community. The alleged fraud was discovered after a nine-month probe by the Federal Audit Office.

Wolfgang Gerke, professor of finance at the University of Erlangen-Nuremberg, told the Financial Times: "If this kind of thing had happened at one of the banks that BaFin regulates, it would have said that corporate governance was inadequate."

The regulator said its IT chief had been suspended several weeks ago. He was arrested this week on his return from a holiday in Africa. Prosecutors said he had admitted partial responsibility for the fraud.

BaFin said it had launched an "intensive examination of its internal processes".

Between 2003 and 2006, prosecutors said, the manager built a luxurious lifestyle with a penthouse flat and several cars complete with chauffeur.

The prosecutors and BaFin refused to identify any of the people involved by name.

Additional reporting by Birgit Jennen in Berlin and Thorsten Kramer in Bonn