Deutsche Bank AG

Deutsche Bank under pressure over derivatives sales in Spain

Potential mis-selling of currency contracts to small companies scrutinised in probe and lawsuits

Deutsche Bank started an investigation after becoming concerned it may have sidestepped the EU's Mifid II rules © Bloomberg

Stephen Morris in London and **Olaf Storbeck** in Frankfurt 3 HOURS AGO

Deutsche Bank is under pressure over its sale of complex currency products in Spain as regulators await the results of an internal probe into contracts that pushed some small companies into financial distress and led to a series of out-of-court settlements.

The Financial Times reported last month that Deutsche had launched an investigation codenamed Project Teal after clients complained they had been sold sophisticated derivatives products they did not understand.

The German lender started an investigation after becoming concerned it may have sidestepped the EU's Mifid II rules designed to protect small businesses from risky lending. It confirmed the probe to the FT and said a "limited number of clients" might have been affected.

"Internally, this issue is seen as toxic," said a person briefed on the investigation. The European Central Bank, Germany's BaFin and the Spanish financial regulator CNMV are following the matter closely and will determine whether to take action after the internal review, people familiar with the situation said.

The affair adds to pressure on Deutsche chief executive Christian Sewing, who has pledged to improve the lender's internal controls after repeated breaches and billions of euros in penalties over the past decade.

Certain senior Deutsche investment bankers in London and Spain appear to have targeted small, financially unsophisticated import/export companies with €10m-€100m of annual sales for more than a decade until 2019.

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Prosper Lamothe Fernández, Autonomous University of Madrid

A 2009 IMF paper examined the role of these sort of instruments, sold by a variety of banks around the world, in stoking the financial crisis.

"[The SMEs] have confidence in their banks and are not aware that these products will put them in a risky position," said Prosper Lamothe Fernández, a finance professor at the Autonomous University of Madrid. He has assessed the contracts of affected companies and provided expert testimony in court.

Fernández estimates that between 300 and 500 Spanish companies could have suffered losses on the products as far back as 2006, including transactions with lenders other than Deutsche. The average hits were between €5m and €10m, people familiar with several of the disputes said.

The losses pushed some clients into acute financial problems, and a few companies took Deutsche to court in Spain. Some of the cases were dismissed, but the German bank settled with several others, people involved in the arbitration said.

Azimutel, an electronics components wholesaler based in Gandia, Valencia, in 2007 bought a series of foreign-exchange hedging products, which pushed it close to bankruptcy, according to court documents.

In 2011, a Madrid court nullified the contracts and ordered Deutsche to pay €1.4m to Azimutel. Deutsche's appeal against the verdict was rejected in 2014. The court ruled that the bank did not meet its obligations under European law related to client suitability. Azimutel declined to comment.

Several other small companies — some currently in talks with Deutsche, as well as some who already settled — declined to be interviewed, citing confidentiality requirements.

The products in question are foreign exchange swaps, derivatives called "targeted accrual redemption notes and forwards" (Tarn and Tarf). They were pitched by Deutsche's salespeople as a cheaper way to hedge exposure to currency pairs, such as the dollar-euro, than traditional exchange rate insurance.

Small companies were told the products were "zero premium" with no initial cost and could even make the clients money, according to people familiar with the matter. In a stable currency market, the derivatives sometimes benefited clients. However, if volatility increased and the exchange rate swung beyond a pre-determined barrier, the cost could rapidly multiply.

"It is impossible for the client to quantify or calculate the cost of the product," said Julio Ribelles, a Valencia-based lawyer who successfully represented Azimutel and other claimants against Deutsche. "You are essentially betting against the bank, but they know the formulas, they have the algorithms and the specialised software."

The practice at Deutsche continued even after Mifid II, which came into force in 2018, prohibited the sale of sophisticated derivatives to small companies. The rules permit clients to ask to be treated as more sophisticated in order to access a wider range of products, and Deutsche encouraged clients to do so.

Deutsche Bank told the FT that it "disagrees" with the notion that it mis-sold complex derivatives to a large number of Spanish SMEs over many years, and that these products pushed some clients close to bankruptcy. "This depiction of events is similar to unsubstantiated allegations already made by a Spanish law firm seemingly to encourage speculative legal action against the bank," it said.

A person briefed on the matter said that Deutsche was aware of fewer than 10 mis-selling disputes over its two-decade history of selling the products Spain, including some that the bank won. The person added that such products were "widely sold in Spain by a wide range of banks".

"As usual, we follow the evidence and diligently look for any potential similar activity," Deutsche added. "We do not intend to comment further until all elements of the investigation are complete."

The Spanish financial regulator CNMV was notified of such incidents by companies involved as far back as 2011 but has not taken action. CNMV said it is aware of the situation but would only comment when a decision or action is taken. BaFin and the ECB declined to comment.

Larger, more sophisticated companies have also shouldered big losses from similar contracts. Spanish wine exporter J García Carrión is currently suing Goldman Sachs in London's High Court to demand a partial refund of $6.2m of losses caused by currency derivatives. Goldman argues that the products were not overly complex for a multinational company.

Additional reporting by Ian Mount in Madrid