GERMANY – Full Answers

1. Provision of banking services by a foreign bank, without a local licence, on cross border basis

1.1 To what extent can a foreign bank (which is not locally authorised) provide the services listed in 1.3 (on a cross border basis) to local retail customers, commercial clients and wholesale counterparties?

Pursuant to section 32 paragraph 1 sentence 1 of the German Banking Act ("KWG"), anyone wishing to conduct banking business or to provide financial services in Germany commercially or on a scale that requires a commercially organised business undertaking requires a written licence. Pursuant to the German Federal Financial Supervisory Authority ("BaFin") banking business is conducted or financial services are provided in Germany not only if the provider of the service has its registered office or ordinary residence in Germany but also if the provider of the service has its registered office or ordinary residence outside of Germany and "actively approaches" the German market in order to offer the respective services in a repetitive manner and at a commercial scale to undertakings or persons that have their registered office or residence in Germany ("zielgerichtetes Wenden an den deutschen Markt") irrespective whether they are (i) professional clients or retail clients or (ii) acting as a principal or as agent. The threshold for such an active approach is considered very low by both the BaFin and German courts (for example, a German language website may already be deemed an active approach of the German market).

Thus, if according to the remarks below [question 1.2] the respective services require licensing, this applies to the provision of such services locally through a subsidiary or a branch as well as on a cross-border basis.

1.2 Where local authorisation or licensing is required, are there any useful exemptions?

Deposit taking and payment services/provision of bank accounts

- Deposit taking: Without licensing generally only allowed in case of non-commercial deposit taking activities (low threshold; commercial scale is generally already assumed if more than five individual deposits which collectively exceed EUR 12,500 are being held or, irrespective of the value, more than 25 individual deposits are being held; this is only a rough guideline, though and an assessment can only be made on a case-by-case basis)

- Useful exemptions: Repayment obligations in form of bearer bonds or negotiable bonds; deposits for which the depositor has agreed to a "qualified subordination" (i.e. subordination in case of insolvency proceedings; repayment cannot successfully be claimed if this would lead to an insolvency of the deposit taking entity).

- As to payment services: Credit institutions according to Art. 4 of the regulation (EU) no. 575/2013 ("Capital Requirement Regulation" or "CRR") which are entitled to operate in Germany do not

require a separate payment services licence in Germany. A payment service provider of an EU or EEA country may passport its licence into Germany according to section 26 of the German Payment Services Regulation Act ("Zahlungsdiensteaufsichtsgesetz" or "ZAG"). Otherwise a licence according to section 8 ZAG is required.

- Provision of bank accounts: In our view, the provision of bank accounts goes hand in hand with deposit taking activities and therefore according to the aforementioned generally requires a licence.

Lending (either secured, e.g. on land/real estate, or unsecured) and other forms of finance such as trade finance

- Any form of lending activities generally requires a licence if done on a commercial scale (low threshold; as a rule, commercial lending can already be assumed in case of more than 100 loans irrespective of the total loan amount or more than 20 loans jointly exceeding EUR 500,000).

- Exemptions: Sales financing, i.e. credit financing of own sales; mere deferral, mere acquisition (which might qualify as regulated factoring, though) and servicing of loans (as long as no credit decisions are made); "qualified subordination" of the lender (see above).

Originating/purchasing/selling debt participations (secured or unsecured), such as syndicated loans or securitised debt obligations

- Syndicated loans fall within the scope of lending as described above (as the case may be, syndicated loans may be subject to a licensing exemption).

Debt participations:

  - Depending on the individual case, the purchase or sale of debt participations may fulfil the requirements of various financial services which according to the German Banking Act typically require a licence, e.g. deposit business, investment broking, purchase and sale of financial instruments in the name of and for the account of others (contract broking), proprietary trading, portfolio management etc.).

  - Origination of debt participations might fall within the scope of the German Capital Investment Code ("Kapitalanlagegesetzbuch" or "KAGB") and would then generally require a licence. The KAGB generally applies to "investment funds" ("Investmentvermögen") which are legally defined as collective investment undertakings which raise capital from a number of investors, with a view to investing it in accordance with a defined investment policy for the benefit of those investors and which are not operative companies outside of the financial sector. There are exemptions which allow for a "circumnavigation" of the regulation under the KAGB; the topic is very complex though and can only be assessed on a case-by-case basis.

1.3 To what extent can a foreign bank (which is not locally authorised) promote the services below locally? Where there are restrictions on promotion, are there any useful exemptions?

- **Deposit taking and payment services/provision of bank accounts;**

- **Lending (either secured, e.g. on land/real estate, or unsecured) and other forms of finance such as trade finance;**

- **Originating/purchasing/selling debt participations (secured or unsecured), such as syndicated loans or securitised debt obligations.**

[No answer]

1.4 Can a foreign bank establish a local representative office to promote such services where these are to be conducted by the bank on a cross border basis (and not by the local office)?

An institution domiciled outside Germany may operate representative offices in Germany if it is authorised to conduct banking business or provide financial services in its home state and if it has its head office there. Official notification is necessary with regard to each, the intention and realisation of setting up of a representative office; operation may not be started before confirmation from BaFin has been received. Please note that the threshold for actions which are deemed to exceed mere representative functions is very low.

2. Provision of investment services from home country without a local license

2.1 To what extent can a foreign bank or investment firm (which is not locally authorised) provide the services below to local retail customers, commercial clients and wholesale counterparties? Are there any useful exemptions?

For the general licensing requirement for the conduct of banking business or the provision of financial services in Germany commercially or on a scale that requires a commercially organised business please see the remarks to question 1 above.

Except for buying investments, the named services will likely be deemed financial services. Thus, if such services are provided commercially or on a scale that requires a commercially organised business undertaking, they usually require a licence and thus cannot be provided by a foreign entity without such a licence.

Buying investments is per se not a regulated activity, provided that it is not carried out as a service for third parties which then might qualify as prop-trading. However, buying investments may be part of a regulated activity such as discretionary management. In this case, the service rendered, e.g. the discretionary management, requires a licence.

BaFin release: Foreign entities may be eligible for exemption from the licensing requirements pursuant to section 32 paragraph 1 of the KWG if the entity does not require supervision, given the nature of the business it conducts (see section 2 paragraph 4 of the KWG). However, such exemption is hardly ever given by BaFin.

Distribution of (non) EU funds:

> A non EU asset management company may market units or shares in non EU collective investment schemes or EU collective investment schemes managed by it in Germany after having notified BaFin. Different rules apply to the non EU asset management company depending on the type of investor marketing at (professional or semi-professional investor). However, the non EU asset management company will not require a particular licence; the product must go through a notification procedure.

2.2 To what extent can a foreign bank or investment firm (which is not locally authorised) promote the services below locally? Are there any useful exemptions?

- **Dealing in/buying/selling investments (as principal or as agent)**
- **Investment advice**
- **Discretionary management**

[No answer]

3. Local rules

3.1 When a foreign bank/investment firm enters into an agreement with a local customer, are there any restrictions on the contract being governed by foreign law and the courts of the foreign country having exclusive jurisdiction (i.e. is the contract required to be governed by local law and/or must the local courts have jurisdiction)?

Especially with regard to consumer protection there are various regulations applicable:

Regarding the place of jurisdiction:

With regard to especially Switzerland the Lugano Convention applies which is largely similar to the regulation (EC) no. 44/2001. As consequence a consumer may bring proceedings against the other party to a contract either in the courts of the state in which that party is domiciled or in the courts for the place where the consumer is domiciled and proceedings may be brought against a consumer by the other party to the contract only in the courts of the state in which the consumer is domiciled. According to Art. 17 Lugano Convention these provisions may be departed from only in very limited cases.

Besides of this, this question depends on whether there is an international treaty with priority or not. Otherwise German local rules of jurisdiction do apply.

Regarding the applicable law:

The regulation (EC) no. 593/2008 (“Rome I”) is applicable in Germany even when the involved countries are both not member states, Art. 2 Rome I. According to Art. 6 (2) Rome I parties may choose the applicable law. However, this choice may not have the result of depriving the consumer of the protection afforded to him by provisions that cannot be derogated from by virtue of the law which, in the absence of choice, would have been applicable (e.g. section 134 and 138 of the German Civil Code (“Bürgerliches Gesetzbuch” or “BGB”) regarding statutory prohibitions, violation of moral principles and profiteering; section 305 et seqq. BGB regarding general terms and conditions; warning and information obligations with regard to investors; section 312 et seq. BGB revocation right regarding doorstep selling).

4. Regulatory appetite for foreign banks

4.1 What is the attitude of your national regulatory authority to cross border business and the presence of foreign banks?

The regulatory standards and the supervision by BaFin generally, i.e. irrespective of the origin of the institution, are very strict.

As a rule, an institution with its registered office or ordinary residence outside of Germany has to obtain a licence if it wants to provide banking or financial services in Germany. Such institution is deemed, by regulatory practice, to provide banking or financial services in Germany if it “actively approaches” the German market in order to offer the respective services in a repetitive manner and at a commercial scale to undertakings or persons that have their registered office or residence in Germany (“zielgerichtetes Wenden an den deutschen Markt”). The threshold for such an active approach is considered very low by both the BaFin and German courts (for example, a German language website may already be deemed an active approach of the German market).

4.2 Is it generally more common for foreign banks to operate locally through a branch or a subsidiary, or both (and does this depend on the activities the bank carries out)?

Banks from the EU prefer branches to minimise capital requirements and regulation by the German authorities. Some offshore banks establish corporates in the UK, the Netherlands or Luxembourg which, in turn, establish German branches.

4.3 Is it mandatory, in any situation, to operate through a branch or subsidiary?

No, branches are able to do all the things that a subsidiary can do: conduct transactions, rent an office, hire staff, and send profits back home.

However, below the level of a branch or a subsidiary, banks from outside the EEA sometimes only establish a representative office which is only allowed to perform general marketing activity (not related to a specific product), relationship management and to collect business data in Germany.

4.4 What are the benefits/disadvantages of operating through a branch or subsidiary?

A branch is not considered a distinct legal entity from the foreign company, whereas a subsidiary is regarded as an independent German company. From a practical point of view, a branch is more of an extension of the parent company. It cannot act by itself and has no board of directors. Its creation involves fewer formalities.

A subsidiary, on the contrary, is owned by the parent company and is run by the latter. It can act by itself and has its own board of directors, declaration of non-objection and internal rules. A subsidiary is required to hold shareholders' meetings and comply with other corporate formalities.

Setting up a branch has the following advantages:

- No minimum assigned capital is required for setting up a German branch.
- No intervention of a German notary public is required for opening up a branch.
- Apart from a few exceptions, German corporate law does not impose any requirements regarding the establishment of a board of directors, the distribution of profits or the organisation of shareholders' meetings.
- Setting up a branch offers also a number of tax advantages.
- For some companies, a branch office as an extension of headquarters also fits better with their legal and tax parent structure.
- A branch can generally be closed down at any time. Subsidiaries can be terminated only by way of a formal liquidation procedure which requires more time. If operations in Germany are intended to be temporary or if the prospects for the near future are very uncertain, establishing a branch instead of a subsidiary is preferably.

Setting up a subsidiary has the following advantages:

- Because the subsidiary and the parent company are distinct legal entities, the parent company is not exposed to any liabilities of its subsidiary. The liability of the German subsidiary is limited to its own assets. By contrast, a foreign investor is always liable for the activities of its German branch. This means execution of the branch's liabilities can be enforced at the expense of the foreign investor's assets, even if these are located abroad.
- Through a subsidiary it is possible to avoid situations in which a board member of the parent company becomes liable in respect of business activities of the subsidiary.
- The domestic subsidiary and its parent company are also subject to tax separately. A subsidiary may also enjoy tax advantages.
- From a commercial point of view, a subsidiary will be considered a German or European company rather than a foreign company.
- If the foreign company is liquidated or falls into insolvency, the effects of such liquidation or insolvency also extend to the German branch office.

5. Establishing a branch

5.1 Does a branch have rights/recognition to trade in other countries

A branch which as part of an entity (a branch from the German legal perspective is never an independent entity but always a part of the main entity) which is licensed with BaFin in Germany or which by way of EU

passport is allowed to provide regulated banking or financial services in Germany may only provide such services within the borders of Germany. The legality of the provision of regulated banking or financial services of such German branch cross-border in another state depends on the regulatory provisions in the state in which said services shall be provided.

5.2 How is a branch regulated?

In case of a branch of an entity which is not located in an EU member state, the entity needs to apply for a licence with BaFin in order for the branch to provide regulated banking or financial services in Germany, i.e. the branch is regulated "through" the entity to which it belongs so that there is no difference between the regulation of the entity and the branch.

In case of branches of EU member state banks or financial services providers, such branch may profit from the home member state licence of the entity to which it belongs. Even in case of EU passporting, though, the branch is subject to certain regulatory provisions and therefore to BaFin supervision. Excerpt of important German law provisions which apply to branches holding an EU passport:

- Prohibited business, section 3 of the KWG (e.g. deposit business if the majority of the depositors are persons employed by the institution/branch (company savings banks)), conduct of lending business or deposit business if, by agreement or in line with standard business practice, it is not permissible or extremely difficult to withdraw the amount of the loan or the deposits in cash).

- Instructions by BaFin in case of suspicion of financing a terrorist organisation etc., section 6a KWG

- Prohibition of certain means of advertising, section 23 KWG

- Collection and use of personal data of clients, section 10 subsection 2 KWG

- Numerous statutory obligations to notify BaFin or to disclose information to BaFin and/or German Central Bank ("Deutsche Bundesbank") (e.g. in case of changes regarding the branch office, notification of loans of EUR 1,000,000 or more, general duties of disclosure towards BaFin/right of examination of BaFin, presentation of statistical reports to German Central Bank.

- General power of BaFin to employ the means necessary to counteract undesirable developments in the banking and financial sector which – among others – may impair the proper conduct of banking business or provision of financial services, section 6 subsection 2 KWG.

6. Establishing a subsidiary

A subsidiary of a third country (non-EEA) institution generally requires a licence according to section 32 (1) KWG to do banking business or to render financial services in Germany. However, there is a possibility to be exempted from this requirement in case that there is an effective supervision of the responsible home country authority and cooperation with BaFin. Nevertheless, the exemption is a decision on a case-by-case basis. However, with regard to Swiss institutions there is for example some facilitation due to a special agreement between the Swiss Financial Market Supervisory Authority ("FINMA") and BaFin.

7. Supervision

7.1 Which national regulatory authority authorises, regulates and supervises foreign banks/investment firms/subsidiaries in your jurisdiction?

See the regulatory chart.

7.2 Is there any split in supervision between the local regulator and the foreign/home regulator – e.g. in the case of locally authorised branch?

With regard to third country (non-EEA) institutions, there is no split in supervisions. As a branch of a third country bank or financial services provider generally has to apply for a ("full") licence with BaFin (as passporting is not possible), the branch is subject to the same regulations as an originally German bank or financial services provider.

For branches of EU member state banks or financial services providers which have passported their business, there might be a certain regulatory split between BaFin regulatory rules and the supervision by the home regulator. This is because the German supervisory rules have "gold-plated" certain EU regulations, e.g. investor-protecting rules that have to be complied with for German financial services providers. Please find below the most relevant examples but note that a conclusive answer is not possible but depends on the individual case (home member state and what kind of financial services are provided):

- Statutory product information (pre-PRIPS) there is a statutory obligation to provide (as retail clients classified) clients with a two-paged information sheet similar to the UCITS KIID for every financial product in case of providing investment advice (purchase advice).

- Inducement catalogue: Further, German financial services providers have to maintain an inducement catalogue containing the use of inducements and their designation to enhance the quality of the investment service.

- "Minutes" of the investment advice have to be prepared and handed out to the client in advance of any order related on such advice (otherwise a revocation-right might be applicable).

8. Individuals

8.1 Where a local branch or subsidiary is established and (if applicable) authorised, are individuals personally regulated and/or liable to fines?

Obviously, board members, managers, other employees as well as controllers of credit institutions or financial services institutions are criminally liable in accordance with German criminal law if these persons commit an offence in Germany (territoriality principle, section 3 German Criminal Code or "StGB").

Among others, decision makers of a bank can be held criminally liable for embezzlement (section 266 StGB) in case of lending contrary to duty. This would apply if a decision maker grants a loan without having diligently evaluated – on the basis of comprehensive information – the chances and the risks of such loan beforehand.

- Indicators for an insufficient risk assessment are, among others: the exceedance of the maximum credit limit; self-serving acting of the decision maker; the responsible person is not authorized to grant a certain loan.

- The decision maker's non-compliance with section 18 KWG (obligation to require the borrower to disclose his financial situation, in particular by submitting his annual accounts, at certain thresholds) has an indicative effect in this respect as well.

Compliance Officers of banks/investment firms etc. are criminally liable for nonfeasance (cf. section 13 StGB): If a bank's employee commits criminal offences with regard to the bank and the Compliance Officer does not intervene, the latter is liable for aiding and abetting.

Banks' and financial services institutions' managers can be held criminally liable in case of deficiencies of their risk management system if the firm's survival is threatened hereby (54a KWG; imprisonment up to five years or fine).

Furthermore, managers can be subject to a fine according to section 130 of the Act on Breaches of Administrative Regulations ("OwiG") if they infringe their obligatory supervision (in such cases the manager's negligence is sufficient).

The representatives of credit/financial services institutions can be liable to fines up to EUR 200,000 for several reasons (e.g.: exceeding the credit limit, lending without the required documentation/information) according to sections 56 KWG and 9 OWiG.

According to section 36 (1) KWG, BaFin is able to recall banks' and financial services institutions' managers in several cases, for instance if there is a lack of personal reliability (e.g. if a financial crime has been committed or if criminal proceedings are pending) or professional qualification. In such cases BaFin is even able to recall the managers' eligibility to act as board members of financial institutions at all. The same applies with regard to members of the supervisory body.

8.2 Does this extend to individuals overseas/in the home country?

With regard to criminal liability the territoriality principle applies (see [question] above).

However, according to section 25l KWG ("Group-wide compliance with due diligence standards"), credit and financial services institutions shall develop group-wide internal safeguards in order to prevent money laundering, terrorist financing and other criminal actions, also they must ensure compliance with the due diligence standards of the Money Laundering Act and of the KWG with regard to their subsidiaries and branches. The managers shall be responsible for the proper fulfilment of these duties. Hence, German managers may be liable for nonfeasance if they do not implement such group-wide standards overseas.

8.3 Which officers and employees are subject to local vetting, and are the owners/controllers subject to local vetting?

According to section 25c KWG, the managers of a credit or financial services institution have to be qualified, reliable and have to devote sufficient time to their duties (there are tight restrictions concerning the acceptable number of mandates). To this effect, BaFin regularly performs fit and proper tests.

Section 33 KWG lists all the cases in which a banking licence will be denied by BaFin, including:

- If there are facts suggesting that one of the managers is not reliable
- If the owner of a significant share or, if this is a legal entity, a representative, or if it is a partnership, even a partner is not reliable
- If there are facts suggesting that the owner or a manager do not have the professional qualification in order to manage such credit/financial services institutions

Besides, the German legislator requires credit and financial services institutions to appoint several officers in order to ensure that these institutions comply with certain legal provisions. Almost all officers that are legally required (such as the Compliance Officer, the Anti-Money Laundering Officer and the Data Privacy Officer) are subject to local vetting. For instance, AML Officers must have sufficient expertise for the performance of their function; Compliance Officers are subject to extensive requirements regarding their position and duties; Data Privacy Officers must ensure their required reliability and expertise.

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