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Germany

BANKING & FINANCE

Contributor

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This country-specific Q&A provides an overview of banking & finance laws and regulations applicable in Germany.

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GERMANY

BANKING & FINANCE



1. What are the national authorities for banking regulation, supervision and resolution in your jurisdiction?

Within the framework of the Single Supervisory Mechanism (SSM), competence for licensing is distributed between European Authorities and the national authority (Bundesanstalt für Finanzdienstleistungsaufsicht-BaFin). Competence for licensing CRR-institutions (i.e. undertakings the business of which is to take deposits or other repayable funds from the public and to grant credits for its own account, Art. 4 para. 1 no. 1 CRR) remains exclusively with the European Central Bank (ECB).

For all national undertakings as well as branches of foreign banking and financial institutions that do not fall within the scope of CRR-institutions, authority for licensing remains with BaFin that works closely with Deutsche Bundesbank (German Central Bank)

The European Banking Authority (EBA) ensures a common standard for banking supervision, and may, in specific cases of breach of EU law by the national entities, take action directly against the national authorities.

2. Which type of activities trigger the requirement of a banking licence?

Anyone wishing to conduct banking business or provide financial services in Germany commercially or on a scale which requires a commercially organised business operation needs written authorisation from the authority.

The terms “banking business” and “financial services” comprise a series of activities listed under Section 1 KWG.

Activities of a banking business may comprise, by way of example, deposit business, credit business, discount business, or principal brooking services.

Financial services comprise, by way of example,

investment brooking, investment advice, operation of multilateral trading facility, placement business, contract brooking, portfolio management, factoring, financial leasing, foreign currency dealing, asset management, limited custody business.

Exceptions to the requirement of a banking license may apply, e.g. when a company provides financial services exclusively for its parent, subsidiary or sister company, for example through cash pooling within a group of undertakings (“group privilege”).

Several activities such as payment services as well as e-money businesses require the authorisation of BaFin according to specific provisions.

3. Does your regulatory regime know different licenses for different banking services?

The applicant may request a “full” permission as a CRR-institute or request permission for single activities or services.

Also, BaFin may grant authorisation subject to conditions or limit its authorisation to specific types of banking business or financial services. Payment services and the issuance of e-money require a licence according to the Payment Services Supervision Act (Zahlungsdienstleistungsaufsichtsgesetz - ZAG).

4. Does a banking license automatically permit certain other activities, e.g., broker dealer activities, payment services, issuance of e-money?

The scope of permitted activities depends on the applicant’s request for licensing and the activity concerned. A license issued by the ECB for CRR-institutes permits the widest range of activities, i.e. all banking activities that fall under the scope of banking business and financial services as well as payment services, including the issuance of e-money.

5. Is there a “sandbox” or “license light” for specific activities?

No. There is no “license light” neither did Germany adopt measures to provide a regulatory sandbox. In particular, BaFin did not establish a “sandbox” with respect to FinTech undertakings as some other jurisdiction did. However, FinTech undertakings may request a preliminary (non-binding) opinion from BaFin in order to determine whether a license is required or not by submitting a specific form provided by BaFin.

6. Are there specific restrictions with respect to the issuance or custody of crypto currencies, such as a regulatory or voluntary moratorium?

By amendment to the banking act (KWG) in 2019, custody services of crypto currencies qualify as financial services; thus, an undertaking offering on a commercial basis custody of crypto currencies requires a banking license. A simplified procedure is not provided.

With respect to activities in the field of custody of crypto currencies with domestic relevance, there is no possibility for institutions licensed in the European Economic Area to operate based on the “European PASS” without separate permission from the national authority.

7. Do crypto assets qualify as deposits and, if so, are they covered by deposit insurance and/or segregation of funds?

The legislator did not qualify crypto assets or virtual currencies as deposits.

8. What is the general application process for bank licenses and what is the average timing?

As already stated, anyone wishing to conduct banking or financial services business in Germany requires a written permit to do so. The licence is finally granted by the ECB in consultation with BaFin. As the national banking supervisory authority, BaFin continues to be the primary contact for the ongoing activities of the licensing procedure.

The granting of the licence is linked to high requirements, such as proof of a minimum initial capitalisation, professional suitability and reliability. BaFin provides information on which formalities and

requirements have to be fulfilled in order to obtain a licence. In addition, BaFin has published leaflets on its website on individual banking transactions, which allow an assessment of whether a certain business activity qualifies as a banking transaction requiring a licence within the meaning of the KWG.

The application for a licence to conduct banking business is to be addressed to:

BaFin – Federal Financial Supervisory Authority

Division BA 31 Common Procedures

Graurheindorfer Strasse 108

53117 Bonn

Tel.: 0228 / 4108 -0

E-mail: licensing@bafin.de

It is advisable to contact BaFin and the head office of the Deutsche Bundesbank responsible for the supervision even before submitting an application, as additional requirements may be necessary in individual cases.

Pursuant to Section 33 para. 4 KWG, BaFin must inform the applicant whether authorisation will be granted or declined within six months of the applicant having submitted the complete documentation required for the granting of authorisation. If documentation has not been submitted sufficiently, BaFin will in any case reject the application after expiry of twelve months.

9. Is mere cross-border activity permissible? If yes, what are the requirements?

Due to rights of freedom of establishment and freedom to provide services, credit institutions authorised in another member state of the EEA may carry out their business in another EEA member state. The legal framework provides a “European passport” for both outgoing and incoming business activities. Incoming undertakings domiciled in an EEA member state that intend to open a branch in Germany or to provide services (also via internet) must notify their national supervisory authority or, where applicable, the ECB that will forward notification to BaFin. After assessment of the notification, BaFin will send the foreign EEA-institution a “Welcome Letter”.

10. What legal entities can operate as

banks? What legal forms are generally used to operate as banks?

Pursuant to Section 2b KWG, banking or financial businesses may not be operated in the legal form of a commercial sole proprietorship. Commonly used entities for the operating business of banks are stock companies (Aktiengesellschaft (AG) or Societas Europaea (SE)), limited liability companies (GmbH), limited partnerships or co-operative societies (Genossenschaften).

11. What are the organizational requirements for banks, including with respect to corporate governance?

Data security, cybersecurity, data governance, third-party providers and data protection at financial institutions are under constant scrutiny.

A special focus of banking regulation is on the digitalisation process. BaFin provides the framework for the technical and organisational equipment of the institutions - in particular for the management of IT resources and for IT risk management.

Digitisation is also one of the focuses of the supervisory authorities. For example, the Deutsche Bundesbank and BaFin are jointly testing the earnings situation and resilience of small and medium-sized banks (so-called Less Significant Institutions - LSIs) in several series the last years and are examining the IT systems and associated IT processes in all banks and financial institutions.

Corporate Governance requirements are highly regulated in a complex system of laws, guidelines and soft law. Main provisions are set forth under Section 25a KWG according to which a bank shall have in place a proper business organization to ensure compliance with the legal provisions. Mainly, such business organization shall provide an effective risk management and controlling mechanisms such as adjustment strategies, appropriate risk management regular ad-hoc stress tests, data management and sufficient technical and organizational resources. Of crucial practical importance is the national authority's guideline on the Minimum Requirements for Risk Management ("MaRisk"). Even though those guidelines do not qualify as legal acts, they have *de facto* binding effects.

The responsibility to ensure a compliant organization lies jointly with the management board.

12. Do any restrictions on remuneration policies apply?

As a result of the global financial crisis of 2007/2008, the incentive systems of the large financial institutions became the focus of regulation and supervision. The financial crisis had made it clear that incentive systems that primarily reward short-term success and focus exclusively on financial performance targets can lead to risks for the individual financial institution and the financial sector as a whole. If, on the other hand, the systems are based on long-term performance measurement with adequate consideration of the risks taken as well as non-financial performance, they can make an important contribution to the long-term success of the financial institutions and thus support financial stability. The focus is particularly on variable remuneration, the so-called bonuses.

This led to the development of dedicated remuneration requirements, which have been applied in the EU since the end of 2010, not only for large credit institutions, but for all credit institutions. In Germany, this results in a comprehensive and detailed set of regulations consisting of directly applicable European regulations and national regulations in the KWG as well as the Regulation in the Institutsvergütungsverordnung (Instituts-VergV).

In essence, these requirements can be summarised as follows: the risk management of credit institutions must include appropriate, transparent remuneration systems that are geared towards the sustainable economic development of the institutions. In detail, a distinction is made between requirements that apply to all employees and those that apply to the most important decision-makers, the so-called risk takers. In addition, for reasons of proportionality, a distinction is made as to whether the institution is a significant institution within the meaning of the KWG or not. The larger, more complex and thus more systemically relevant a credit institution is, the higher the regulatory and supervisory requirements for risk management and thus also for the remuneration systems. The requirements cover both content-related and process-related aspects.

13. Has your jurisdiction implemented the Basel III framework with respect to regulatory capital? Are there any major deviations, e.g., with respect to certain categories of banks?

The EU Basel III policies and framework have been implemented by the European Union by the CRR and the Capital Requirements Directive (CRD) that are directly applicable on national level as well as by amendments to

the KWG mainly under Sections 10 et seqq. KWG and in the solvency ordinance; the latter specifies in detail how the minimum capital requirements are to be determined with respect to credit risk, market risk and operational risk.

Initial capital consisting in Common Equity Tier 1 capital is required in accordance with the applicable threshold:

- 50,000 EUR: investment advisers, investment brokers, contract brokers, asset managers and portfolio managers, operators of multilateral trading systems or undertakings engaging in placement business who, in providing financial services, are not authorised to obtain ownership or possession of funds or securities of customers and who do not trade in financial instruments for their own account;
- 125,000 EUR: other financial services institutions which do not trade in financial instruments for their own account;
- 730,000 EUR: financial services institutions which trade in financing instruments for their own account, financial services institutions which provide a limited custody business within the meaning of section 1 (1a) sentence 1 number 12 KWG, as well as securities trading banks;
- 5 million EUR: CRR credit institutions.

14. Are there any requirements with respect to the leverage ratio?

Leverage ratio, a Pillar I requirement of the Basel III package, is laid down in the Capital Requirements Regulation (CCR). Since 2015, regular reporting and disclosure on leverage ratio to the national supervisory authority is mandatory for credit institutions. With amendment to the CRR in 2019, following the EBA's report and considerations on a leverage ratio to ensure a credible backstop function, leverage ratio has been fixed at 3%.

15. What liquidity requirements apply? Has your jurisdiction implemented the Basel III liquidity requirements, including regarding LCR and NSFR?

Liquidity requirements including LCR and NSFR are set forth in CRR, CRD as well as in KWG and Solvibilitätsverordnung (solvency directive). The liquidity coverage requirement provides for the credit institution's duty to provide a minimum liquidity buffer to

cover any net cash outflows during a 30-day stress scenario. Institutions are required to report monthly on their LCR positions.

As regards fund requirements, according to Article 92 CRR, institutions must, at all times, provide a common equity tier 1 capital ratio of 4.5%, a tier 1 capital ratio of 6.0% and a total capital ratio of 8.0%.

However, to uphold the principle of proportionality, small and non-complex institutions are permitted to alternatively apply a simplified NSFR.

16. Do banks have to publish their financial statements? Is there interim reporting and, if so, in which intervals?

Banks have to publish their financial statement on a yearly basis in accordance with the national laws applying to the respective legal entity (such as the requirements according to the Aktiengesetz – German Act on Stock Companies) as well as, in specific cases, in compliance with the International Financial Reporting Standards.

17. Does consolidated supervision of a bank exist in your jurisdiction? If so, what are the consequences?

CRR and CRD IV provide for measures of consolidated supervision whereas Sections 10 and 10a KWG specify further rules as to consolidated supervision of groups. In the context of consolidated supervision, the corporate group is looked at as a unit rather than on an individual basis, particularly with regard to capital requirements.

18. What reporting and/or approval requirements apply to the acquisition of shareholdings in, or control of, banks?

Generally, Acquisition, increase, reduction, disposal or loss of control over the target entity are subject to disclosure and notification requirements.

Pursuant to section 2c KWG any intention to acquire a significant holding must be reported by means of notification using the forms published by the authorities without undue delay to BaFin and Deutsche Bundesbank's regional office. Details as to the required documentation are set out in the Holder Control Regulation (Inhaberkontrollverordnung) and any changes that might occur after notification and submission of documents must be reported to the authorities.

19. Does your regulatory regime impose conditions for eligible owners of banks (e.g., with respect to major participations)?

A person with the intention of acquisition of or increase in the significant holding must present documentation that may lead to the authority's assumption of the person's (or, if a legal entity is concerned, its legal representative's) trustworthiness and suitability to meet the requirements of a sound and prudent management of the institution. BaFin checks the owner's reputation by assessing, inter alia, criminal records, insolvency proceedings, professional training, qualifications, experience and financial positions.

20. Are there specific restrictions on foreign shareholdings in banks?

In the context of notification on acquisition or increase of a significant holding, the national authority BaFin may require additional information and documents if the applicant is situated or supervised in a non-EEA state.

21. Is there a special regime for domestic and/or globally systemically important banks?

Pursuant to Section 10f KWG, BaFin and Deutsche Bundesbank identify at least annually which institutions, EU parent institutions or parent financial holdings are to be classified as Global Systemically Important Institutions (GSI). BaFin will set a minimum capital buffer rate at 1%, 1.5%, 2%, 2.5%, 3% or 3.5% of the total risk exposure amount. The rate is reviewed annually.

22. What are the sanctions the regulator(s) can order in the case of a violation of banking regulations?

A natural person who conducts banking business or provides financial services without the required authorisation commits a criminal offence and can be subject to imprisonment for up to three or five years or a fine.

In addition, the entity in which the unauthorized business is conducted can be fined up to 5 or 10 million EUR.

In case of violations of regulatory requirements, BaFin can impose several sanctions such as administrative or disciplinary fines or issue orders to the institutions or

their managers or demand the dismissal of the managing directors.

23. What is the resolution regime for banks?

Within the common European framework of the Single Resolution Mechanism (SSM), the EU member states introduced uniform rules for the resolution of credit institutions, establishing the Single Resolution Board (SRB) and the Single Resolution Fund (SRF).

Entities and groups directly supervised by the ECB (generally CRR-institutions) and cross-border groups fall within the SRB's exclusive responsibility. The ECB assesses the risk of failure of a bank whereas SRB remains the authority to place the bank under resolution, following a resolution scheme that provides for different tools. BaFin remains responsible for all other banks in Germany.

The provisions of the European Recovery and Resolution Directive have been transposed in the German Act on the Recovery and Resolution of Credit Institutions (SAG). SAG's regime provides for i) preparation of recovery plans; ii) early intervention; iii) intragroup financial support; iv) resolution tools such as bail-in; v) cross-border cooperation between the national and the European supervisory and resolution authorities.

24. How are client's assets and cash deposits protected?

In Germany, deposit protection is based on statutory protection schemes and voluntary protection schemes. In 2015, Germany implemented the requirements under the European Directive on Deposit Guarantee schemes into national law (*Einlagensicherungsgesetz*). All credit institutions are required to protect their clients' assets through a statutory deposit guarantee scheme. Statutory protection must ensure a compensation of EUR 100,000 per depositor and bank.

Voluntary insurance schemes have been established for the different banking sectors.

25. Does your jurisdiction know a bail-in tool in bank resolution and which liabilities are covered?

Bail-In-tools exist for national resolution authority BaFin as well as in the remit of the SRB; through a bail-in, shareholders and creditors may be required to participate in the institution's losses and recapitalisation.

Institutions are required to hold a minimum of eligible liabilities to ensure the effectiveness of the bail-in tool.

Upon submission by the institution of a restructuring plan, BaFin may use the bail-in tool to write down eligible liabilities in full or in part and/or convert these liabilities into shares or other Common Equity Tier 1 instruments. However, BaFin prioritizes other tools before making use of the bail-in procedure.

The bail-in tool can be applied to all liabilities that are not expressly excluded from the scope of bail-in. A key exclusion is for covered deposits i.e. deposits up to the amount covered by a deposit guarantee scheme.

26. Is there a requirement for banks to hold gone concern capital ("TLAC")?

The TLAC standards came into force in 2019 and apply to systematically important banks. From 2022 on, the standard has been increased to 18 per cent of risk-weighted assets and 6.75 per cent of the leverage ratio exposure.

Upon request of the resolution authority (BaFin) other banks under the supervision of the national authority

must meet the Minimum Requirements for Eligible Liabilities (MREL) that are determined by BaFin individually for each institution.

27. In your view, what are the recent trends in bank regulation in your jurisdiction?

Highly flexible and fast evolving FinTech products and undertakings using new technologies are a challenge for both jurisdiction and supervisory authorities. Policies and strategies to deal with the opportunities as well as risks, also in terms of adequate IT infrastructure, might be a trending task in the nearest future.

28. What do you believe to be the biggest threat to the success of the financial sector in your jurisdiction?

German banking still requires fundamental transformation and lower costs. Consolidation may be part of the equation. However, banks must also think in terms of business model renewal, encompassing the customer proposition, use of data and analytics, and further digitalisation. Finally, speed is of the essence.

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