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Doing business after Brexit: Introductory remarks from a German perspective

Michael Born (Of Counsel – Financial Services)

Status Quo

Hope for the best, but prepare for the worst:

> "Anything which fails to respect the referendum or which effectively divides our country in two would be a bad deal and I have always said ***no deal is better than a bad deal***."

Prime Minister Theresa May, 21 September 2018
(after EU summit in Salzburg)

Market access for third country institutions

- Physical market access:
  - **Setting up a new subsidiary**: New authorisation will be needed; subsidiary may be used as EEA hub under EU passport regime
  - **Acquisition of an authorized entity**: Authorisation already obtained; shareholder control proceedings to be taken into account
  - **Application for third country branch authorization**: Pursuant to Sec. 53 KWG, (dependent) third country branch is deemed to be (independent) credit institution/investment firm by way of legal fiction; BaFin has indicated that "converting" an existing passported branch may result in a quicker application process (provided that main features of the business model remain the same); third country branch cannot be used as EEA hub under EU passport system

Market access for third country institutions (continued)

- Non-physical market access:

  - **Application for an exemption** pursuant to Sec. 2 (5) KWG: Exemption also covers licensing requirement; will only be granted if BaFin deems that there is no need for supervision; rather restrictive approach of BaFin to be expected; priority of ESMA registration in case of investment firms

  - **Registration in register of third-country firms kept by ESMA** in accordance with Art. 46 *et seqq.* MiFIR (in case of investment firms): Equivalence decision by the Commission required; ESMA must establish cooperation arrangements with the relevant third country authorities; a registered third country firm may provide investment services to eligible counterparties and professional clients in the EU without the establishment of a branch

  - **Reverse solicitation** (cf. below)

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Exemplary basic issues

Minimum local substance; outsourcing

- The ECB and BaFin have communicated that “letterbox” or “empty shell” undertakings will not be tolerated

- In particular, <u>booking models</u> will be subject to critical review:

  – ECB FAQ (Status: 2 Aug. 2018): “The ECB and the national supervisors will assess booking practices (including back-to-back and remote booking) and the associated risks when a license application is submitted and by carrying out ongoing supervision (monitoring). <u>The booking models of incoming and existing banks should not result in “empty shells”, a reliance on the provision of services from third-country entities or impediments to swift implementation of recovery measures</u>. Banks are also expected to be able to operate sufficiently on a stand-alone basis (i.e. independently of group support). […]”

  – The ECB has published a detailed presentation “Supervisory expectations on booking models” in August 2018.

Exemplary basic issues

Reverse solicitation

- Services requested by persons and entities domiciled in Germany <u>on their own initiative</u> are not subject to licensing requirements

  – BaFin Guidance Notes (2005): “There is no restriction on the so-called <u>freedom to provide requested services (*passive Dienstleistungsfreiheit*)</u>, i.e. the right of persons and entities domiciled in Germany to request the services of a foreign entity on their own initiative. Transactions requested on the client's own initiative are therefore not subject to the licensing requirements under Sec. 32 (1) of the KWG.”

  – Art. 42 MiFID II: “Member States shall ensure that where a retail client or professional client […] established or situated in the Union initiates <u>at its own exclusive initiative</u> the provision of an investment service or activity by a third-country firm, the requirement for authorization […] shall not apply to the provision of that service or activity by the third country firm to that person […].”

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Exemplary basic issues

Reverse solicitation (continued)

- Problem: Scope of reverse solicitation regarding new products/ services
  - BaFin Guidance Notes (2005): Only "range of products within the scope of existing business relationships"
  - Art. 42 MiFID II: "[…] An initiative by such clients shall not entitle the third-country firm to market otherwise than through the branch, where one is required in accordance with national law, new categories of investment products or investment services to that client.

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Exemplary basic issues

Branching back

- Open question: Will UK branches of an authorised EU/EEA entity be permitted to provide cross-border services to customers in EU/EEA countries based on the headquarter authorisation?

  – ECB FAQ (Status: 2 Aug. 2018): "The ECB and the national supervisors believe that the purpose of branches in third countries is to meet <u>local needs</u>. The ECB and national supervisors do <u>not</u> expect that branches in third countries perform critical functions for the credit institution itself or <u>provide services back to customers based in the EU</u>."

  – Recital 23 of CRD IV: "Branches of credit institutions <u>authorised in third countries</u> should not enjoy the freedom to provide services […] in Member States other than those in which they are established."
  => *argumentum e contrario*: Do branches of credit institutions <u>authorised in the EU/EEA</u> enjoy such freedom?

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Michael joined the Frankfurt practice in 2018. Prior to joining, he worked for a major German law firm in Frankfurt and London. He is qualified as German lawyer (Rechtsanwalt) and holds a PhD from the University of Bonn.

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