

GERMAN DRAFT LAW CLARIFIES LICENCE REQUIREMENTS FOR OWN ACCOUNT TRADING

The German Federal Government has proposed an amendment to the German Banking Act (*Kreditwesengesetz*, "KWG") which clarifies German licence requirements for cross-border own account trading (*Eigengeschäft*).

CURRENT REGIME

The KWG distinguishes dealing on own account (*Eigenhandel*) and trading on own account (*Eigengeschäft*) as two separate licensable investment services under the KWG.

Pursuant to section 1 para. 1a no. 4 KWG, dealing on own account is:

- a) The continuous offering to purchase or sell financial instruments at self-determined prices (**Market Making**);
- b) The organised, frequent and systematic dealing on own account on a substantial basis when executing client orders outside a regulated market, an MTF or an OTF without operating a multilateral system (**Systematic Internalisation**);
- c) The purchase or sale of financial instruments for own account as a service to others; or
- d) The purchase or sale of financial instruments for own account as a direct or indirect participant in a domestic regulated market or a multilateral trading facility *via* high-frequency, algorithmic trading scheme characterised by (i) infrastructure intended to minimise network and other types of latencies, including at least one of the following facilities for algorithmic order entry: co-location, proximity hosting or high-speed direct electronic access, (ii) system-determination of order initiation, generation, routing or execution without human intervention for individual trades or orders and (iii) by a high volume of intraday reports in the form of orders, quotes or cancellations, also where no service is provided to others (**High Frequency Trading**).

Trading on own account means the purchase and sale of financial instruments for own account (section 1 para. 1a sentence 3 KWG) which is no dealing on own account, *i.e.*, which is no "service to others" (see item c) above). Hence, purchasing and selling financial instruments for own account without providing a service to others qualifies as trading on own account whereas acting on own

Key issues

- Mere own account trading by non-EEA entities with counterparties based in Germany is not subject to a licence (including where such entity conducts banking business or provides investment services under a BaFin waiver pursuant to section 2 para. 5 KWG).
- Non-EEA entities would not require a licence for own account trading as participants or members of German exchanges or trading venues.
- Own account trading *via* direct electronic access and dealing on own account continues to be licensable.

Own account dealing / own account trading under German law:

- Dealing on own account (*Eigenhandel*) is the purchase and sale of financial instruments for own account as service to others, usually to fill orders received from clients (it also includes market-making, systematic internalisation and high frequency trading)
- Trading on own account (*Eigengeschäft*) means the purchase and sale of financial instruments for own account which is not qualified as dealing on own account, *i.e.*, which is lacking of a "service element" and is not related to a (potential) client transaction.

account to fill orders received from a client qualifies as dealing on own account.

As of today, own account trading, triggers a German licence requirement, amongst others, pursuant to section 32 para. 1a KWG if

- a) own account trading is conducted in addition to licensable banking business and investment services other than financial leasing, factoring, foreign exchange business or AIF related custody business;
- b) own account trading is conducted as participant or member of a regulated market or multilateral trading facility ("**MTF**") or by using a direct electronic access to a trading venue irrespective of whether additional banking business or investment services are conducted; or
- c) own account trading is conducted in commodity derivatives or emission allowances or derivatives thereof.

The licence requirement is subject to various exemptions.

This regime was introduced in early 2018 when implementing Directive (EU) 2014/65 ("**MiFID II**"). Until mid-2018, non-EEA firms could rely on grandfathering (section 64x para. 8 KWG) in relation to items b) and c) above, *i.e.*, they could continue own account trading as members or participants of a German regulated market or MTF or via direct electronic access or in commodity derivatives or emission allowances or derivatives thereof if a complete application for a waiver pursuant to section 2 para. 5 KWG had been submitted.

On 29 March 2019, the German Brexit law (*Brexit-Steuerbegleitgesetz*, "**BrexitStBG**") entered into force re-establishing a modified version of such transitional regime for UK firms in a no-deal Brexit scenario. A waiver will be deemed to have been granted by the German Federal Financial Supervisory Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht*, "**BaFin**") as of Brexit date until ESMA decides on the registration of the respective firm in the third-country firms register pursuant to Article 48 of the Regulation (EU) 600/2014 ("**MiFIR**"), provided that a complete waiver application is filed within three months after Brexit date by such UK firm.

However, BaFin has outlined that it will construe the Brexit law in a narrow sense and that the deemed waiver would not be available for "merely extending" existing European passports beyond Brexit date. Hence, the deemed waiver could only be available to firms which have not yet been active in the German market under the European passport and which do not provide banking and financial services. Apart from that, the BrexitStBG does not address any further aspects arising under cross-border own account trading.

PROPOSAL BY THE GERMAN FEDERAL GOVERNMENT

With respect to licence requirements for own account trading, the German Federal Government has proposed to clarify the licence requirement under section 32 para. 1a KWG. The [proposal](#), which was published on 5 September 2019 in connection with a draft law implementing Regulation (EU) 2019/834 (EMIR REFIT), does not affect the transitional regime under the BrexitStBG, which, however, needs to be implemented by BaFin with a general decree (for further background, please see our client briefing of 14 December 2018 https://www.cliffordchance.com/briefings/2018/12/germany_preparesfornodeal_brexitupdate.html).

Pursuant to the proposal, a licence for own account trading pursuant to section 32 para. 1a KWG is not required, if own account trading on German exchanges or trading venues is conducted by non-EEA entities as participants or members of such exchange or trading venue (the "**Own Account Exemption**"). The Own Account Exemption will apply until ESMA publishes a decision pursuant to Article 48 MiFIR.

The German Federal Government considers the Own Account Exemption reasonable because members or participants of (supervised) exchanges or trading venues are already subject to the venue's admission and trading rules and are supervised by the exchange authorities and BaFin. The German Federal Government deems the level of supervision sufficient until access rights have been harmonised within the EU.

The German Federal Government also clarifies that the licence requirements outlined under item a) above are triggered only where the third country entity (this would include UK and non-UK firms) provides licensable banking business and investment services and holds a German banking licence pursuant to section 32 para. 1 KWG. Mere own account trading by non-EEA entities with counterparties based in Germany does not trigger licence requirements including where such entity conducts banking business or provides investment services under a BaFin waiver pursuant to section 2 para. 5 KWG. This is because, in contrast to the own account dealing, own account trading does not include any client-related service and does, hence, not "target" the German market.

CONSEQUENCES AND REMAINING QUESTIONS

The proposal only covers own account trading but not own account dealing. Hence, purchasing and selling financial instruments as a service to others as well as market making and high frequency trading continue to trigger licence requirements if conducted "in Germany". Based on the long established German cross-border regime, an activity is conducted in Germany if it targets persons or entities resident in Germany. Hence, solicitation triggers licence requirements if no other exemptions apply; conversely, German residents may request services from non-German service providers without triggering licence requirements for such service providers if there was no prior solicitation attributable to such service providers – ("passive rendering of services exemption").

In addition, own account trading *via* direct electronic access to a German trading venue continues to be a licensable activity as well as own account trading in commodity derivatives or emission allowances or derivatives thereof.

NEXT STEPS

The draft law will presumably enter into force early 2020. If there is a no-deal Brexit before that date, BaFin may well take the above mentioned upcoming legislative changes into account when implementing the Brexit StBG by way of a general decree and adjust its administrative practice accordingly.

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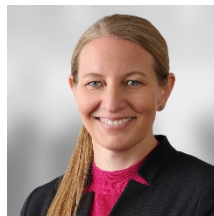
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