

NEW GERMAN OWNERSHIP CONTROL REGIME CREATES MORE ONEROUS OBLIGATIONS IN FINANCIAL INSTITUTIONS M&A

On 11 June 2021, the German Federal Financial Supervisory Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht*, "**BaFin**") closed its consultation to proposing substantial amendments to the German Ownership Control Regulation (*Inhaberkontrollverordnung*, "**InhKontrollIV**"). These amendments mainly serve to implement the Joint Guidelines on the prudential assessment of acquisitions and increases of qualifying holdings in the financial sector published by the European Supervisory Authorities on 20 December 2016 ("**Joint Guidelines**")¹ and to make further technical adjustments driven by recent changes to the German Insurance Supervision Act (*Versicherungsaufsichtsgesetz*, "**VAG**") and in the German Banking Act (*Kreditwesengesetz*, "**KWG**"). This briefing summarises the key changes which affect in particular investments by sovereign wealth, private equity and hedge funds as well as by investors from third countries outside the European Economic Area intending to acquire a qualifying holding in a credit institution, financial service institution, insurance or re-insurance undertaking or pension fund ("**Regulated Entity**").²

OBJECTIVES OF THE INHKONTROLLV

Generally, the InhKontrollIV specifies the information which a proposed acquirer will have to provide to BaFin in order to allow BaFin (and the ECB in case the target is a CRR credit institution) to assess the proposed acquisition in a complete and timely manner. The main focus is whether the proposed acquirer (and the relevant persons representing the proposed acquirer) are "fit and proper", whether the designated managers are experienced and reputable and whether the proposed acquirer is financially sound.

JOINT GUIDELINES

The objective of the Joint Guidelines are to improve the legal certainty, clarity and transparency of the supervisory approval process with regard to

Key aspects of the revised InhKontrollIV:

- Increased documentation requirements for sovereign wealth, private equity and hedge funds
- Proposed acquirer must disclose willingness and ability to inject further capital into the target company
- Proposed acquirer must assess the impact on the group structure in relation to consolidated supervision of the target undertaking and the group

¹ https://esas-joint-committee.europa.eu/Publications/Guidelines/JC_QH_GLs_EN.pdf.

² The InhKontrollIV does not apply to investment firms (*Wertpapierinstitute*) subject to the EU Investment Firm Regulation and the German Investment Firms Act (*Wertpapierinstitutengesetz*) as the ownership control procedure for investment firms is harmonised under Delegated Regulation (EU) 2017/1946 and will be further specified by the German Ownership Control Regulation for Investment Firms (*Wertpapierinstituts-Inhaberkontrollverordnung*, "**WpI-IV**") which is currently under consultation by BaFin.

acquisitions and increases of qualifying holdings in the financial sectors and to create a level playing field with respect to ownership control procedures throughout the EU.

As such the Joint Guidelines are addressed to the national competent authorities, including the ECB when acting a prudential supervisory authority within the SSM, which reflect them their national administrative practices.

KEY CHANGES TO INHKONTROLLV

Extended scope for certain proposed acquirers

Implementing Annex I section 5 no. 3 to 5 of the Joint Guidelines, the amendments to the InhKontrollV expand the scope of documents to be provided by private equity funds, hedge funds, sovereign wealth funds or investors located outside in a third country outside the EEA.

As such the InhKontrollV requires the following additional information:

- a clearance certificate or, where the third country does not issue clearance certificates, an equivalent certificate issued by the third country's financial supervisory authority in relation to the person subject to the notification requirement;
- if available, a statement from the third country's financial supervisory authority that there are no restrictions to provide the required information about the new shareholder which BaFin needs for supervising the target; and
- a summary of the prudential regulatory requirements of the third country which apply to the proposed acquirer.

A sovereign wealth fund will be required to provide the following additional information:

- details regarding the ministry or government department responsible for setting the fund's investment policy;
- details of the investment policy and any investment restrictions;
- the names and job titles of the persons making investment decisions for the fund; and
- details of the influence exercised by the ministry or government department on the day-to-day management of the fund and the target company.

If the reporting party is a private equity fund or a hedge fund, it must submit the following additional information:

- a detailed description of the performance of previous acquisitions by the proposed acquirer of qualifying holdings in Regulated Entities;
- details on the investment policy and any investment restrictions, including details on the investment monitoring;
- factors serving the proposed acquirer as a basis for investment decisions related to the target undertaking and factors that would trigger changes to the proposed acquirer's exit strategy;
- the proposed acquirer's decision-making framework for investment decisions, including the name and position of the individuals responsible for making such decisions; and

- a detailed description of the proposed acquirer's anti-money laundering procedures and of the anti-money laundering legal framework applicable to it.

The revised InhKontrollV in particular extends the requirements for sovereign wealth, private equity and hedge funds to provide further details on their internal decision making processes and their investment strategy. In practice and in particular in relation to financial investors from a third country which have not been approved by BaFin at previous transactions, BaFin has already reviewed these internal procedures under the current InhKontrollV in detail so the proposed changes merely reflect the prevailing administrative practice. However, the revised InhKontrollV now formally introduces these extended transparency requirements without granting much discretion to BaFin.

Practical substitutes for declaration of reliability

Providing the required declaration of reliability³ in relation to all entities controlled by the proposed acquirer could potentially be difficult in practice, in particular for private equity investors and sovereign wealth funds which do not always have the legal ability to request such information from their portfolio companies due to legal restrictions applicable locally, including insider restrictions. In such cases, the revised InhKontrollV provides for the possibility to coordinate with BaFin potential substitutes which can be provided instead of the declaration of reliability. In the past, BaFin has already accepted substitutes where the provision of a declaration of reliability was legally not possible. For instance, substitutes which have been considered as sufficient by BaFin from our experience were a declaration of reliability based on facts received from reviewing publicly available information such as annual reports etc.

Impact on group structure

In implementing Annex I section 8 of the Joint Guidelines the amended InhKontrollV requires proposed acquirers to provide BaFin with an analysis of the perimeter of consolidated supervision of the target company and the group that it would belong to after the proposed acquisition. This includes information on the group entities in scope of consolidated supervisory requirements after the proposed acquisition and at which levels within the group these requirements would apply on a full or sub-consolidated basis. Such analysis must also include information as to whether the proposed acquisition will impact in any way the ability of the target company to continue to provide timely and accurate information to BaFin.

Financial transparency

The revised section 15 InhKontrollV also enhances the requirements to provide financial transparency for the business plan in relation to the proposed acquisition where a proposed acquirer would gain control over the target company. As such the proposed acquirer must disclose in the business plan its willingness and ability to provide further capital to the target company in the future, if this becomes necessary.

In practice BaFin and ECB have already frequently checked the willingness to provide further capital during the ownership control procedure and even in some cases granted the approval under the condition that further capital (up to a previously agreed threshold) needs to be provided upon BaFin's/ECB's

³ In such declaration of reliability the proposed acquirer has to declare whether any of its controlled portfolio companies has been subject to criminal proceedings, administrative offences, insolvency proceedings or regulatory proceedings.

request. The amendments to the InhKontrollV now formally implement this administrative practice.

Reduced information requirements

To the extent that the proposed acquirer has been assessed by BaFin within the previous two years, regarding the information already held by BaFin, that proposed acquirer should only provide those pieces of information that have changed since the previous assessment. Hence, under the revised InhKontrollV, the relevant period triggering a re-submission requirement is extended from one year to two years in line with the expectations provided under Annex I section 13 no. 3 of the Joint Guidelines.

In any event, BaFin and ECB are free to require a "declaration of no change" by the proposed acquirer to confirm there is no need to update such information, since it remains unchanged from the previous assessment.

OUTLOOK

In summary, the proposed changes to the InhKontrollV form a basis for already established administrative practice, including implementing the Joint Guidelines or requirements ECB imposed with respect to CRR credit institutions. While BaFin and ECB were willing to explore alternative ways with respect to the relevant documentation to be submitted, the explicit wording of the former InhKontrollV created barriers to a more proportional interpretation. While most of these issues have not been solved, and the proposed InhKontrollV has on balance increased the burden for potential acquirers, the framework is now much clearer and transactions should benefit.

For BaFin and ECB, ownership control procedures are an opportunity to reassess the business model and strategy of Regulated Entities and the authorities must also fulfil their role as gatekeepers. So only well prepared applications will provide the desired results and proposed acquirers are well advised to focus on the ownership control procedure and treat this a key element of the transaction.

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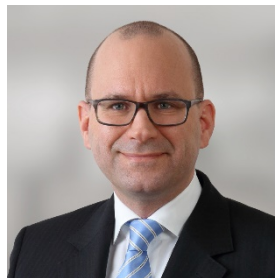
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