New Rules for the Acquisition of Financial Institutions in Germany

– The Implementation of the Acquisitions Directive in Germany –

Frankfurt
March 31, 2009

I. Introduction

On March 17 and 24, 2009, Germany adopted new rules for the acquisition of financial institutions as a result of the transposition into German law of Directive 2007/44/EC1 (the “Acquisitions Directive”). The Acquisitions Directive was prompted particularly by certain protectionist tendencies of national governments and a biased attitude of bank regulators against foreign potential acquirers, as could be observed, for example, in the takeover battles for Italian banks Banca Nazionale del Lavoro and Banca Antonveneta, as well as government interference with the takeover of Polish bank BPH by UniCredit. The new rules are set forth in the German Law on the Implementation of the Acquisitions Directive (Gesetz zur Umsetzung der Beteiligungsrichtlinie - the “Implementing Act”)2 and a supplemental regulation on ownership control (Inhaberkontrollverordnung – the “Regulation”).3 The new rules amend certain provisions of the German Banking Act (Kreditwesengesetz – “KWG”)4 on the proposed acquisition and increase of significant holdings (i.e., 10% or more of the voting rights or share capital) in German financial institutions (i.e., credit or financial services institutions). In a nutshell, the new rules have significantly increased the amount of information to be provided to the German Federal Financial Supervisory Authority

4 The Acquisitions Directive sets forth similar rules for the acquisition and increase of holdings in insurance companies and the Implementing Act, thus, also provides for amendments to the German Insurance Supervisory Act (Versicherungsaufsichtsgesetz). The discussion in this memorandum is limited to the rules and amendments applicable to financial institutions. It does not apply, however, to the acquisition of significant stakes in asset management companies.
(Bundesanstalt für Finanzdienstleistungsaufsicht – “BaFin”) and the German Central Bank (Deutsche Bundesbank) by a potential acquirer of a significant holding in a German financial institution and, thus, significantly increase the burdens for potential acquirers. The 60 business day regular review period means that the timeframe for the BaFin review remains generally unchanged; however, the potential for an extension of the review period has been significantly increased.

Given current valuation levels, German financial institutions (the “Targets”) may present very interesting investment opportunities. The following gives an overview of the rules on ownership control, as amended by the Implementing Act and the Regulation, focusing on those that we expect to become most relevant to potential acquirers. More specifically, the overview will address important new procedural aspects (see II.1 below), changes in the scope of application of the notification obligation (see II.2 below), the significantly expanded information requirements to be met (see II.3 below), and the grounds based on which the BaFin may prohibit a proposed acquisition (see II.4 below).

II. Overview of the New Rules

1. Procedural Aspects

Old law. Old Section 2c KWG did not set forth detailed information requirements to be met by the potential acquirer in connection with an intended acquisition or increase of a significant holding in a financial institution. Rather, in addition to the limited information requirements listed in the form of notification to be submitted to the BaFin and the Bundesbank published on the BaFin’s website, the BaFin could at any time during the three-month review period request further information, such as, e.g., a curriculum vitae (“CV”) of the potential acquirer’s legal representatives, evidence for the source of funds used for the acquisition or increase, as well as certain financial information. Such further information requests could, but did not necessarily, result in a delay of the review procedure. Although the review period could not be formally shortened, the BaFin had developed an informal administrative practice of issuing a “negative statement” prior to the expiration of the three-month review period upon request of the potential acquirer. Such “negative statement” would be issued if the BaFin was satisfied with the Notification and the information provided; it was in essence a confirmation by the BaFin to the effect that based on the information at hand there were no reasons for a prohibition of the proposed acquisition or increase of the significant holding. Acquisitions of significant holdings in financial institutions were often closed on the basis of such a negative statement. Although formally the old law is applicable to all Notifications submitted prior to March 17, 2009, we understand that the BaFin started to apply the substantive standards contained in the new rules before then.
Implementing Act. New Section 2c(1a) KWG provides for a regular review period of 60 business days from confirmation by the BaFin of receipt of a complete notification (the “Notification”).

- Receipt of the complete Notification must be confirmed by the BaFin in writing vis-à-vis the potential acquirer within two business days specifying the end of the 60 business day review period; a Notification is complete, if it has been completed on the revised form of Notification\(^5\) and is accompanied by all information/documents specifically listed therein.

- Additional information may be requested by the BaFin up until the 50\(^{th}\) business day of the review period; the review period is suspended from the request until receipt of such additional information, however for not more than 20 business days.

- Under certain circumstances, such as, e.g., if the potential acquirer is domiciled or supervised outside of the European Economic Area, the 60 business day review period may be extended by up to further 30 business days.

- An official German translation must be submitted for all documents in languages other than German that have been filed together with the Notification. However, the BaFin may, on a case-by-case basis, grant an exemption from this translation requirement.

- Changes relating to information contained in the Notification must be communicated to the BaFin without delay. A failure to update a Notification or updates filed less than five business days prior to the end of the review period may result in a prohibition of the intended acquisition by the BaFin.

\(^5\) BGBl. I 2009, p. 572.
The following shows a generic timeline for the preparation of a Notification and the BaFin review process.

2. The Scope of Application of the Notification Obligation

Underwriter carve-out. Pursuant to new Section 1(9) Sentence 3 KWG, a bank acquiring shares constituting a significant holding in a financial institution in its capacity as “underwriter” will be explicitly exempt from the Notification obligation, provided that it (i) will not exercise the voting rights appertaining to such shares or otherwise influence the issuer’s management and (ii) sell the shares within half a year from their acquisition. This underwriter carve-out will clarify the old law, which did not explicitly address the acquisition of shares in a financial institution in an underwriting context. At the same time, it will confirm the BaFin’s former practice, pursuant to which underwriting banks generally did not have to file a formal Notification of the intended acquisition of shares constituting a significant holding in a financial institution with the BaFin, if they
coordinated in advance with the BaFin. It is not entirely clear whether the underwriter carve-out in new Section 1(9) Sentence 3 KWG requires an explicit undertaking of the underwriter in the underwriting agreement that it will not exercise the voting rights from any shares not sold in the offering and will sell the shares within half a year. Also, it is not entirely clear what will happen should the underwriter not be able to sell the shares within half a year. Presumably, the underwriter will then have to file a Notification.

Revised Notification threshold. Under the old law, the holder of a “significant holding”, i.e., a holding of 10% or more of the voting rights or share capital of a financial institution, had to file a Notification with respect to any intended increase of its holding to or beyond the thresholds of 20%, 33%, or 50%. Pursuant to the Implementing Act, the 33% threshold will be lowered to 30%.

Calculation of Notification thresholds. In principle, the method of calculating the size of a holding for the purpose of establishing a Notification obligation remained unchanged: The Notification obligation applies to all shares of the Target held or to be held directly by the potential acquirer or indirectly through a subsidiary of the potential acquirer. In this context, “subsidiary” means any entity controlled by another entity within the meaning of the German Commercial Code (Handelsgesetzbuch) or otherwise subject to a controlling influence. Shares held indirectly through a subsidiary are attributable to the potential acquirer in full and not only *pro rata* in accordance with the size of the potential acquirer’s holding in the subsidiary. Shares of the Target held by third parties may also be attributable to the potential acquirer in full, if, *inter alia*, (i) the shares are held by a third party for the account of the potential acquirer, (ii) the third party holder has transferred the voting rights appertaining to its shares to the potential acquirer, or (iii) the third party and the potential acquirer can be considered as “acting in concert” with respect to the Target shares. The new law has not significantly clarified the scope of application of the attribution of Target shares by means of acting in concert. In particular, it remains unclear whether and to what extent persons or entities which cooperate solely with respect to the acquisition of Target shares but not with respect to the holding of Target shares post acquisition may be subject to a Notification obligation based on the attribution of Target shares by means of acting in concert. The BaFin may interpret certain new language in the Implementing Act as having expanded the scope of application of the attribution of Target shares by means of acting in concert. Acquisition structures which involve two or more entities cooperating with respect to the potential acquisition of Target shares may result in the mutual acquisition of the shares held or to be held by such entities based on acting in concert and, thus, give rise to extended

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6 The rules on determining whether a notification threshold is triggered are not fully harmonized within the EU. For example, in the UK, an acquirer may be viewed as acquiring indirectly a significant holding in a regulated subsidiary of the target even if the acquirer will not control the target upon completion of the acquisition.
Notification obligations. It may be advisable to discuss such acquisition structures with the BaFin at an early stage of the proposed acquisition.

3. **Extended Scope of Information to be Provided together with the Notification**

   For the sake of increased transparency, the Regulation now specifies in detail - by way of a checklist contained in the form of Notification – all information to be submitted by the potential acquirer in connection with a Notification. Follow-up information requests by the BaFin should therefore in the future be less frequent and less burdensome. The following overview summarizes the principal substantive information items to be submitted in connection with a Notification in compliance with the new rules:

   - **Evidence for existence, identity and corporate structure**
     - To the extent applicable, certified copies of the constituent documents and a certified excerpt of the company register of the potential acquirer.
     - To the extent applicable, a list of all personally liable partners and persons authorized to represent the potential acquirer as a matter of law or in a similar capacity.

   - **Target managing directors**
     - A declaration regarding any intended changes in the top-level management of the Target, including any designated replacements.

   - **Description of business activities**
     - A current, complete and meaningful description of the potential acquirer’s business activities.

   - **Assessment by authorities outside the financial sector**
     - A declaration regarding any assessment (whether completed or ongoing) of the intended acquisition by any authority outside the financial sector (in case of a completed assessment, evidence of the outcome of such assessment to be submitted with the Notification).
Shareholder / group transparency

- With respect to all potential acquirers (regardless of whether they belong to a group of companies),
  - A list of all persons or entities ultimately owning or controlling the potential acquirer or being in a position to cause the potential acquirer to acquire or increase the significant holding in a Target, including all persons or entities holding directly or indirectly (see 2. above) more than 25% of the voting rights or share capital of the potential acquirer.

- With respect to potential acquirers that belong to a group of companies,
  - A description of the group structure (including a group chart) reflecting each group member including its respective holding of voting rights or share capital.
  - A description of the group’s business activities.
  - A list of all group members which are regulated entities and active in the financial sector.
  - In the case of a potential acquirer who is an individual, a list of all management positions in group as well as non-group entities and control positions in non-group companies.
  - A list of all persons or entities which are not group members and which hold directly or indirectly (see 2. above) at least 10% of the voting rights or share capital or otherwise exercise significant influence over the potential acquirer (including a description of any voting agreement).

- With respect to potential acquirers that do not belong to a group of companies,
  - In the case of a potential acquirer who is an individual, a list of all management or control positions in other companies.
  - A list of all persons or entities which hold directly or indirectly (see 2. above) at least 10% of the voting rights or share capital or otherwise exercise significant influence over the potential acquirer (including a description of any voting agreement).
The above requirements will significantly increase the upstream transparency requirements compared to the old law, which required only the disclosure of persons or entities exercising control over the potential acquirer, i.e., as a general rule, holding more than 50% of the potential acquirer’s voting rights.

- Extended “fit and proper” assessment

  - Declaration by the potential acquirer with respect to the potential acquirer and, to the extent applicable, each legal representative, personally liable partner and each designated managing director of the Target, whether
    - They are subject to, or have been fined in, administrative or similar proceedings (Ordnungswidrigkeitsverfahren) in connection with their business activities;
    - They are or have been subject to proceedings by any supervisory authority;
    - An authority has denied or revoked their entry in a public register, a permission, membership or business license,
      provided that with respect to any of the above-mentioned circumstances no such declaration has to be submitted if the proceedings concerned were completed by way of a conviction, sanction or other decision more than five years before the beginning of the year in which the Notification will be filed;
    - They have been subject to a “fit and proper” assessment by another supervisory authority or to a similar assessment by another authority in connection with a previous acquisition of a significant holding in a financial institution or in their capacity as managing director of a financial institution (evidence of the outcome of such assessment to be submitted with the Notification), provided that no such declaration has to be submitted if such assessment was completed more than one year before the beginning of the year in which the Notification will be filed.

The above-mentioned declarations are in addition to the declarations by the potential acquirer with respect to it, each legal representative, personally liable partner and each designated managing director of the Target, whether they are or were subject to criminal proceedings or are or were involved in insolvency or similar proceedings; the declaration requirements regarding criminal proceedings remained substantially unchanged from the old law. Under the old law, designated managing directors of the Target were not subject to any of the above information requirements prior to their appointment.
Submission of CVs

- To the extent applicable, a signed CV from each legal representative or personally liable partner of the potential acquirer (or from the potential acquirer, if he or she is a natural person) and from each designated managing director of the Target.

- CVs to list in reverse chronological order the relevant professional experience of the person concerned, including, *inter alia*, the former employer’s name and registered office as well as a detailed job description (type of job and duration, power of representation, internal decision-making competency, business areas, for which the person was in charge); all dates must specify the relevant month and year.

In substance, the above CV requirements correspond with what the BaFin requested under its old administrative practice.

Business, family or other relationships

- Comprehensive description of the existing financial and other interests of the potential acquirer, or of any entity managed or controlled by the potential acquirer, in the Target, including details of business, family or other relationships between the potential acquirer and the Target.

- In particular, a description of (i) all business relations between the potential acquirer, or any entity managed or controlled by the potential acquirer, on the one hand and the Target, any entity under the Target’s control, any of the Target’s shareholders (voting or non-voting) holding at least 5% of the Target’s shares, managing directors or supervisory board members on the other hand, (ii) all family relationships between the potential acquirer and each of its legal representatives or personally liable partners on the one hand and the Target’s shareholders (voting or non-voting) holding at least 5% of the Target’s shares and managing directors on the other hand, (iii) whether any of the potential acquirer’s legal representatives or personally liable partners has a position as managing director or a similar position at the Target, an entity under the Target’s control or at one of its shareholders holding at least 5% of the Target’s shares and (iv) whether any shareholder (voting or non-voting) of the potential acquirer holds at the same time at least 5% of the Target’s shares (voting or non-voting).

- A description of any interests or activities of the potential acquirer that may conflict with the interest of the Target in carrying out its business in a solid and diligent manner.
- **Description of financial condition**

  - Unconsolidated and, where applicable, consolidated financial statements (including management reports, if any) of the potential acquirer, as well as audit reports, for the preceding three business years.\(^7\)
  
  - Cash flow statements and segment reports, if any, for the preceding three business years, as well as the most recent rating reports issued with respect to the potential acquirer and its group, if any, including supporting documentation of the rating agencies.
  
  - In the case of a natural person as potential acquirer, a comprehensive list of and evidence for the potential acquirer’s sources of income, an overview of and evidence for the potential acquirer’s assets and liabilities, as well as, for the past three business years, the financial statements and audit reports, if any, for any enterprise managed or controlled by the potential acquirer.

- **Financing of the acquisition**

  - Meaningful and complete description (including adequate and complete evidence) regarding the availability and sources of the debt and equity to be used to finance the intended acquisition, including all agreements and contracts concluded in connection with the intended acquisition.\(^8\)

- **Business plan, strategic objectives**

  Depending on the size of the intended significant holding in the Target post acquisition, a description of the potential acquirer’s strategic objectives with respect to the Target as follows:

  - Intended holding of a control position

    - Business plan for the Target, including a detailed description of the potential acquirer’s strategic objectives and plans with respect to the Target, namely:

      - Meaningful information regarding the principal purpose of the acquisition as well as the planned measures to reach such purpose, including reasons for the acquisition, medium-term objectives regarding the financial and income situation, synergy targets, potential re-

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\(^7\) This information could also be requested by the BaFin under the old law.

\(^8\) Under the old law, the BaFin could request evidence for the sources of the funds used for the acquisition.
organization of business activities, contemplated reallocation of capital within the Target as well as general guidelines and plans regarding the Target’s integration in the potential acquirer’s group.

- Meaningful business plan information including balance sheets and income statements, projected capital ratios, volume of estimated risk positions and forecast of planned intra-group transactions (each for the next following three business years for the Target and the potential acquirer’s group).

- Meaningful information regarding the effect of the acquisition on the corporate and organizational structure of the Target, including on the composition and responsibilities of the Target’s corporate bodies and the committees established by them, modifications of the accounting methods, significant changes of the control processes (including significant changes regarding internal audit procedures, compliance functions and key employees), significant changes regarding IT systems and IT security and the effect of the acquisition on the guidelines regarding outsourcing of business activities or processes.

➢ Intended holding of between 20% and 50% of the capital or voting rights or of a holding enabling the potential acquirer to exercise significant influence without having control

- Meaningful information regarding the principal purpose of the acquisition as well as the planned measures to reach such purpose, including reasons for the acquisition, medium-term objectives regarding the financial and income situation, synergy targets, potential reorganization of business activities, contemplated reallocation of capital within the Target as well as general guidelines and plans regarding the Target’s integration in the potential acquirer’s group.

- Comprehensive description of the general strategic objectives, including the estimated investment horizon and any foreseeable plans to modify the size of the holding, a description of and reasons for the contemplated influence to be exercised over the Target (including a description of the intended future influence on the Target’s financial situation and capital allocation) as well as information regarding the willingness and ability to provide further capital to the Target, if necessary.
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• Intended holding of less than 20% of the capital and voting rights
  
  • Comprehensive description of the general strategic objectives, including the estimated investment horizon and any foreseeable plans to modify the size of the significant holding.
  
  • Description of and reasons for the contemplated influence to be exercised over the Target.
  
  • Information regarding the willingness and ability to provide further capital to the Target, if necessary.

4. Prohibition of a Proposed Acquisition

The BaFin may prohibit a proposed acquisition during the review period solely based on one or more of the following grounds; in each case, the prohibition must be based on factual circumstances:

- **Failure by the potential acquirer to meet the fit and proper test**\(^9\)
  
  Not only the potential acquirer, but also, to the extent applicable, its legal representatives and personally liable partners must meet the fit and proper test; the prohibition also applies if facts support the assumption that the funds for the acquisition of the significant participation may have been generated through a criminal act.

- **Failure by a designated managing director of the Target to meet the fit and proper test**\(^10\)

- **Failure by the Target to meet certain regulatory requirements**\(^11\)
  
  Relevant regulatory requirements are in particular those set forth in various EU directives in the banking area.

  This ground for prohibition also applies if the integration of the Target in the group of the potential acquirer adversely affects an efficient supervision of the Target.

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\(^9\) This ground for prohibition remained unchanged from the old law.

\(^10\) This ground for prohibition did not exist under the old law.

\(^11\) This ground for prohibition was somewhat extended compared to the old law.
Failure by the non-EU home country regulator of the potential acquirer to perform an efficient supervision of the Target

This prohibition applies in particular if, as a result of the proposed acquisition, the Target would become the subsidiary of a potential acquirer located outside the EU or EEA, which is not subject to efficient supervision by its home country regulator.

Occurrence or increased risk of money laundering or financing of terrorism in the context of the proposed acquisition

Lack of necessary financial soundness of the potential acquirer

Risk that due to its capitalization and financial condition, the potential acquirer will not be in a position to meet the capital and liquidity requirements applicable to financial institutions; the legislative materials point out that the potential acquirer must be able to provide the Target with equity or liquidity in a crisis or to avoid a crisis; neither the law nor the legislative materials distinguish with respect to the size of the proposed acquisition. It remains to be seen how the BaFin will eventually interpret this far-reaching ground for prohibition.

In any event, this ground for prohibition seems to go far beyond what is required under the Acquisitions Directive and related guidance published by the European Committees of Bank Supervisors (CEBS), Insurance and Occupational Pensions Supervisors (CEIOPS) and Securities Regulators (CESR). According to such guidance, the Target supervisor should prohibit the proposed acquisition if it concludes that the potential acquirer is likely to face financial difficulties during the acquisition process or in the foreseeable future (usually three years). The depth of the assessment of the financial soundness of the potential acquirer should be linked with and be proportionate to the nature of the acquirer and the nature of the acquisition.

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12 This ground for prohibition remained unchanged from the old law.
13 There seems to be some overlap with the first ground for prohibition, which applies when there is a risk, that the funds for the acquisition have been generated through a criminal act.
14 This ground for prohibition did not exist under the old law.
15 Guidelines for the prudential assessment of acquisitions and increases in holdings in the financial sector required by Directive 2007/44/EC.
- Failure by the potential acquirer to submit a complete Notification\textsuperscript{16}

  - Failure by the potential acquirer to submit all information initially required as part of the Notification or subsequently requested by the BaFin.

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\textsuperscript{16} This ground for prohibition did not exist under the old law.
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