Global Financial Services Regulatory Guide - Germany

4. How do the licensing requirements apply to cross-border business in your jurisdiction?

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# How do the licensing requirements apply to cross-border business in your jurisdiction?

**Trigger points for license**

**Banking, financial services and investment services**

Where a bank, financial service provider or investment services provider outside Germany deals with a client or a counterparty located in Germany, its activities will typically be subject to German laws and regulations. The bank or service provider will need to consider whether they are triggering a local German licensing obligation. The BaFin issued a guidance note in 2005, clarifying the conditions under which cross-border activities of banks and financial services providers require a license in Germany. This guidance in our view, also applies to investment services as well as payment services and e-money services. The guidance note distinguishes between offering services in a “directed” or “target-oriented way” (which requires a license) and providing services passively, that is, on the initiative of German residents (which does not require a license). This distinction may be difficult to apply, but in general, a foreign institution that does not solicit clients in Germany may, without being licensed, offer banking services, financial services or investment services to German residents upon their initiative and request.

In order to be able to rely on this “passive freedom of services exemption,” it is advisable for the foreign institution to document that a transaction was made solely based upon the customer’s initiative. It is also advisable to rely on the passive freedom of services exemption only in isolated instances; reliance on the exemption for a multitude of transactions would arouse the suspicion of the BaFin. Furthermore, a general solicitation effort by the foreign institution would terminate the exemption.

It is important to note that the guidance note does not contain a “sophisticated investor” exemption. Providing cross-border services to a sophisticated person or institution is treated the same way as providing services to a retail customer. However, in practice, it is easier to rely on and prove facts for a passive sale exemption in the case of institutional clients and very difficult in the context of retail customers.

In general, according to the guidance note, foreign institutions are required to obtain a license in order to offer, on a cross-border basis, banking services, financial services or investment services to customers in Germany where they cannot rely on the passive freedom of services exemption. Except where the EU passport rules discussed below apply, a license requires a permanent establishment (headquarters or branch offices in Germany).

**Payment services**

Pursuant to section 10 (1) of the ZAG, an institution wishing to provide payment services as a payment institution in Germany, commercially or on a scale that requires a commercially organized business undertaking, needs written authorization from the BaFin.

While the BaFin has not issued any specific guidance as to when exactly the license requirement is triggered for foreign providers serving German customers, it can be safely assumed that the same principles apply as with banks and financial services providers and investment services providers, that is, any form of solicitation by any means addressed to German residents will trigger the license requirement.

**Fund managers**

For fund managers, regulation of funds is primarily exercised through the regulation of managers. It requires that the manager be either fully licensed or registered with the BaFin under the KAGB.

The triggering point for the license requirement would be the management of a fund set up under the KAGB, as funds set up under the KAGB may only be managed by a duly licensed or registered fund manager.

Non-EEA funds marketed in Germany do not necessarily have to have a fund manager duly licensed in Germany but would be subject to different rules for obtaining a registration for marketing in Germany under the KAGB.

At present, fund managers that are not domiciled in Germany cannot obtain a license under the KAGB.

**Credit service providers**

The license requirement is triggered whenever someone provides credit services commercially or at a scale that requires a commercially organized business undertaking.

The KrZwMAG is new, but regarding its international scope of application, it is to be expected that the BaFin will likely apply the same standard as regards banks and financial services providers, i.e., non-German credit services providers will fall under the German license requirements if they offer their services in a targeted manner to German clients.

**Insurance undertakings**

Insurance and reinsurance undertakings from a country outside the EEA, who want to carry out (re-) insurance business in Germany, require an insurance license pursuant to section 67 para. 1 sentence 1 VAG. However, if a reinsurance undertaking from a non-EEA country exclusively carries out the business of reinsurance in Germany, it does not require a German reinsurance license provided that the equivalence of the solvency regime for reinsurance undertakings from the respective non-EEA country has been confirmed by the European Commission pursuant to Article 172 para. 2 Solvency II Directive or that a special treaty on reinsurance with a third country applies (section 67 para. 1 sentence 2 VAG).

Even beyond the exception for reinsurance undertakings from third countries with an equivalent solvency regime or a corresponding treaty, it is generally accepted in Germany that a foreign reinsurer does not require an insurance license for carrying out the insurance business by way of correspondence. However, such correspondence will have to be initiated by the customer – i.e. an insurer located in Germany – without any promotional activities of the third country reinsurer directed to customers in Germany ("passive solicitation"). Accordingly, if a reinsurance intermediary is involved in establishing a business contact between the German insurer (customer) and the third country reinsurer, such reinsurance intermediary would have to limit its activities to passive solicitation as well. In 2016, BaFin issued an "Interpretative Decision on Aspects of Carrying out Reinsurance Business via Insurance Undertakings in a Third Country". This "Interpretative Decision" gives further guidance on how BaFin would handle the licensing requirement for third country reinsurers and the conditions under which it would accept "passive solicitation" as an exemption from the German insurance license requirements.

Although BaFin has limited its "Interpretative Decision" to the cross-border business of third country reinsurance undertakings, it is widely assumed in German legal literature that a similar license exemption also exists for direct insurance undertakings from third countries who conclude an insurance by way of correspondence upon the initiative of a customer located in Germany and who have not carried out any promotional activities in Germany. This can also be based on the reasoning of the German legislator and on the reservation in place for Germany under the OECD Code of Liberalization of Current Invisible Operations, pursuant to which insurance by way of passive solicitation shall be free. Accordingly, if an insurance undertaking from outside of Germany actively solicits customers who are located in Germany, the license requirement will typically be triggered. Only if the German customer travels abroad or initiates the business contact with a foreign insurance undertaking without being attracted by advertisements or websites that are directed to customers in Germany, the foreign insurance undertaking can profit from the license exemption for "passive solicitation".

**Insurance intermediaries**

There is no similar rule for the licensing requirement of insurance intermediaries from third countries doing business with customers located in Germany by way of correspondence only, but the analogous application of the rule of "passive solicitation" may well be reasonable. Due to the local structure of the licensing and registration of insurance intermediaries in Germany, however, in practice, the license requirement will only be triggered if an insurance intermediary from a third country starts or intends to start mediation activities in a particular city or local area in Germany.

**Exemptions from the license requirement**

**Banks, financial service providers and investment services providers**

Pursuant to section 2(5) of the KWG, foreign banks and financial service providers may be exempted from the license requirement. An exemption may be granted by the BaFin on a case-by-case review if “the enterprise does not require supervision, given the nature of the business it conducts.” Such an exemption from the license requirement can only be considered for limited business operations. In principle, it is only granted to entities that the BaFin can assume will not require additional supervision in Germany due to the effective supervision in their home country. Foreign institutions may be exempted for transactions involving interbank business and transactions with institutional investors, such as the German federal government, the states, local authorities and their institutions and credit institutions, financial services institutions and investment services institutions, insurance companies as well as certain major corporations. It is not entirely clear whether this exemption also applies to the provision of investment services by foreign investment firms (given that this exemption is in the KWG, but there is no parallel provision in the WpIG) but we believe the better arguments support the view that it is. At the moment, the BaFin is extremely reluctant to grant such exemptions to third-country firms.

Exemptions may also be granted where a foreign entity is a member of a group of an institution licensed in Germany. In particular, an exemption may be granted where a German-licensed institution transfers customers to its foreign parent/subsidiary/affiliate. However, an exemption will only be granted if the entity is effectively supervised in its home country by the competent authority according to international standards and the competent authority of the home state cooperates with the BaFin. Furthermore, the applicant must submit a certificate from the authority of the home country, which confirms that the foreign institution has a license in its home country, that the intended cross-border activities do not raise any supervisory concerns, and that any future concerns will be reported to the BaFin. Again, it is not entirely clear whether this applies to foreign investment services providers but we believe the better view is that it should.

Moreover, the foreign institution must nominate an authorized agent  for the service of documents in Germany.

An institution that is fully licensed in Germany must act as an intermediary if the institution intends to serve retail customers.

For Swiss banks, no intermediary needs to be used for contacting retail customers under a special regime agreed on with the Swiss FINMA subject to an obligation by the Swiss bank to comply with certain conduct of business rules based on MiFID II and compliance with German anti-money laundering rules.

In relation to certain limited activities relating to financial instruments (investment advice and investment brokerage), an exemption is available for intermediation between customers and domestic or “passported” banks and financial and investment services providers or fund managers if the instruments are limited to fund interests (other than hedge funds) registered for distribution in Germany, or certain alternative investments, and such intermediaries or advisers are not holding client assets. However, in such a case, a license requirement for financial investment intermediaries may arise under the German Trade Regulation (*Gewerbeordnung*). This exemption is also provided explicitly in the WpIG in the context of the provision of investment services.

**Payment services providers and e-money issuers**

No specific exemptions for foreign payment services providers or e-money issuers apply other than for activities that are generally exempt from the definition of payment services.

**Fund managers**

No specific exemptions for foreign fund managers apply, except that non-EEA-based funds managed by them may be marketed into Germany if they have been duly registered. In theory, marketing to retail investors is also possible, but in such cases, the requirements for registration are so onerous (including a full prospectus requirement) that there have not been many practical cases. Therefore, foreign fund managers will normally limit any marketing of their funds to professional investors. Still, the costs for obtaining a registration for marketing and ongoing compliance obligations are so high that it is not common practice for non-EEA-based fund managers to register their funds for marketing in Germany.

A reverse solicitation exemption applies to sales of fund interests to German residents, but for all practical purposes, this exemption can only be used with professional or semi-professional investors. Great care should therefore be taken to document the reverse inquiry. Under no circumstances should non-EEA fund managers rely on the reverse solicitation exemption as a strategic option to sell fund interests in Germany.

Pre-marketing, i.e., the provision of information or communication on investment strategies or investment ideas to potential investors, has become regulated in 2021. Such pre-marketing requires prior notification to the BaFin and excludes relying on reverse solicitation for 18 months thereafter with respect to those investors to which the relevant funds were pre-marketed.

It should be noted that there is no option for foreign small fund managers to opt for registration instead of a license if assets under management do not exceed EUR500 million (unleveraged) or EUR100 million (leveraged), except that EEA and non-EEA funds managed by such foreign small fund managers registered in another member state of the EEA may be registered for marketing in Germany under simplified conditions as set out in section 330a of the KAGB.

**Credit service providers**

No credit services license is required under the KrZwMG for German or EEA credit institutions, German or EEA fund management companies, and non-credit institutions supervised under the EU Consumer Credit Directive or the EU Residential Mortgage Credit Directive (such entities do not exist in Germany, though, and this is only relevant in the context of the EU passporting regime discussed below).

**Insurance undertakings**

The VAG does not provide for a specific rule that would allow BaFin to exempt certain foreign insurance or reinsurance undertakings from the licensing requirement in Germany. If a non-EEA insurance or reinsurance undertaking wants to do business in Germany without a German insurance license, it therefore has to remain within the limits of the statutory exemptions from the licensing requirement, such as passive solicitation or reinsurance from a country whose solvency regime has been confirmed as equivalent to EU standards.
However, based on customary practice of BaFin, insurance activities under the NATO Treaty do not require an insurance license if the foreign insurance undertaking only promotes insurance products (except mandatory TPL insurance) to members of the NATO troops (or their dependents) stationed in Germany.

**Insurance intermediaries**

No German insurance mediation license is required in the following scenarios:

If the insurance intermediary acts exclusively for one insurance undertaking (or for more insurance undertakings not competing with each other) that is licensed to do business in Germany and that has taken over the unlimited liability for the mediation activities of the insurance intermediary;

If the insurance intermediary is headquartered in another EU/EEA Member State and can demonstrate that it has been registered under the IDD;

If the insurance intermediary mediates insurance contracts on an ancillary basis only, provided that all of the following conditions set out in section 34 d para. 8 no. 1 GewO are met:

the insurance is complementary to the good or service supplied by a provider

the insurance covers: the risk of a defect, loss of, or damage to, the good or the non-use of the service or the damage to, or loss of, baggage and other risks linked to travel booked with that provider and

the amount of the premium paid for the insurance product does not exceed EUR 600 calculated on a pro rata annual basis; or

the amount of the premium paid per person does not exceed EUR 200, where the insurance is complementary to a service referred to in point (a) and the duration of that service is equal to, or less than, three months.

Should the above conditions not be met, an insurance intermediary who only mediates insurance contracts on an ancillary basis can still obtain an exemption from the licensing requirement upon application pursuant to section 34d para. 6 GewO if it has the necessary professional liability insurance and can demonstrate that it is of good repute, sufficiently qualified and financially stable. The latter requirements can be proven by a declaration of a licensed insurance undertaking or a licensed insurance intermediary, for which the insurance intermediary directly acts, confirming that they will secure the qualification of the insurance intermediary.

If the insurance intermediary mediates insurance products as part of a collective contract of a savings and loan association ("Bausparkasse") that only serve as security for the loan repayment claims of the savings and loan association (section 34d para. 8 no. 2 GewO);

In case of payment protection insurance, which are mediated in connection with loan or leasing agreements as additional service to the delivery of a good or a service, provided that the annual premium does not exceed EUR 500 (section 34d para. 8 no. 3 GewO).

In addition to the explicit exemptions set out in the GewO, it is also generally accepted under German insuranc law that mere "tipping", by which the intermediary does not point to a particular insurance product, but only generally establishes a contact between an insurance undertaking and a potential policyholder, does not require an insurance mediation license (Article 2 no. 2 lit. (c) and (d) IDD).

**Legal consequences of acting without a required license**

According to section 54(1)(no. 2) of the KWG and § 82 WpIG, a person who is conducting a banking, financial service or investment service without a license may be punished with imprisonment for up to five years or with a monetary fine. In the case of a company, the responsible officer may be punished. Moreover, according to section 37(1) of the KWG, the BaFin may order the immediate discontinuation of the business as well as its liquidation, and it may appoint a liquidator for that purpose. In addition, it may publish its intervention against such types of business. The purpose behind this is to prevent potential customers and business partners from concluding further business with the foreign institution concerned.

The same also applies to payment services providers or e-money issuers acting without a license. Under section 63 of the ZAG, the managers of these parties are subject to criminal sanctions; under section 7 of the ZAG, the BaFin may order the immediate discontinuation of such activities and the winding down of an existing business, and it may appoint a liquidator for such purpose.

Transactions concluded with an unlicensed party are not automatically invalid, but customers may have a claim in tort against such party with the remedy of “natural restitution,” that is, they can raise a claim to be put back in the same position as if the prohibited transaction or relationship had not been entered into.

Likewise, it is a criminal act to engage in fund management activities without the necessary license (section 339 of the KAGB). The BaFin can take all appropriate measures and issue administrative orders necessary to enforce the KAGB. While not explicitly mentioned, such authority likely includes issuing an order to immediately discontinue any activities conducted without a license and to stop the marketing and sale of fund interests.

Finally, providing credit services under the KrZwMG without a license (section 43 KrZwMG) is also a criminal act. Further, under section 38 of the KrZwMG, the BaFin may order the immediate discontinuation of such activities and the winding down of an existing business, and it may appoint a liquidator for such purpose.

If an insurance or reinsurance undertaking carries out the business of (re-)insurance in Germany without the required license, its managers commit a criminal act pursuant to section 331 para. 1 no. 1 or para. 3 VAG and may be punished with imprisonment for up to five years (or, in case of negligence, up to three years) or with a monetary fine. In addition, BaFin may order the immediate discontinuation and liquidation of the unlicensed business, it may appoint a liquidator for that purpose and it may publish its intervention against the unlicensed insurance activities (section 308 VAG). The (re-)insurance contracts concluded with a (re-)insurance undertaking without the necessary license will typically remain valid, but they may be subject to rescission by the policyholder.

Carrying out insurance mediation without the necessary license in Germany may be sanctioned by way of an administrative fine of up to EUR 5,000 (section 144 para. 1 no. 1 lit. k, para. 4 GewO); in case of repeated and persistent infringements, or if the illegal mediation puts the life, health or valuable property of a third party at risk, such behavior may also be sanctioned as a criminal act pursuant to section 146 GewO with imprisonment of up to one year or with a monetary fine.

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