

GERMANY

# Investment rules of the world



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At DLA Piper, we have one of the largest finance and projects teams in the world with more than 600 dedicated lawyers and an established local law firm network. We share knowledge and skills in debt instruments, debt securities, funds, derivatives and portfolios, as well as energy, infrastructure and other projects, across Europe, the Middle East, Africa, Asia Pacific and the Americas.

When and wherever we work for you on finance and investment deals and projects, you can rely on our international platform; we are backed by the network and resources of one the largest and most-connected business law firms in the world.

We enjoy being part of your team, bringing experience across sectors, borders and financial products, supporting you on first-of-a-kind deals, in new markets and to grow.

With global perspective, we can help you to realize your financial strategy in whichever markets you do business.

## Investment Rules of the World

With input from across our global network, this guide covers key legal topics for different financial activities and projects and gives you an overview of the points you may consider when initially looking at financing or investing in particular jurisdictions. Please [contact us](#) if you would like to discuss any legal issues or solutions for your business. We also welcome your feedback about this guide via [investmentrules@dlapiper.com](mailto:investmentrules@dlapiper.com).



# Germany

*Last modified 20 October 2017*

## Capital markets and structured investments

### Issuing and investing in debt securities

#### *Are there any restrictions on issuing debt securities?*

German debt securities are predominantly bearer bonds. Issuing bearer bonds does not require any permission and, in particular, does not constitute deposit taking. Raising moneys on the basis of German law registered bonds (*Namenschuldverschreibungen*) may constitute deposit taking and may require a banking license.

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#### *What are common issuing methods and types of debt securities?*

Debt securities are issued either directly or through underwriters purchasing the securities and distributing them to investors. Debt securities may be issued on a stand-alone basis or under a program.

Types of securities include corporate bonds, hybrid bonds (for rating or regulatory capital purposes), convertibles, exchangeables, high yield bonds and a large variety of structured notes (including warrants).

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#### *What are the differences between offering debt securities to institutional / professional or other investors?*

The issuance of unlisted notes to professional investors does not trigger a prospectus requirement while public offers of unlisted notes to retail investors requires the publication of a prospectus. Prospectuses for retail offers are typically based on a special format (the German retail format) containing integrated or consolidated German language terms and conditions.

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#### *When is it necessary to prepare a prospectus?*

It is necessary to prepare a prospectus in the case of non-exempted public offers and listings.

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#### *What are the main exchanges available?*

The main securities exchange is the Frankfurt Securities Exchange operated by Deutsche Börse AG. The Stuttgart stock exchange is important for structured notes.

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### *Is there a private placement market?*

There is a very active private placement market. Debt instruments in this market are primarily German law *Schuldscheine* (debt certificates) and German law registered notes (*Namensschuldverschreibungen*).

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### *Are there any other notable risks or issues around issuing or investing in debt securities?*

#### **Issuing debt securities**

There are no unusual jurisdiction-specific legal risks.

#### **Investing in debt securities**

There are no unusual jurisdiction-specific legal risks.

*Last modified 20 Oct 2017*

## **Establishing and investing in debt / hedge funds**

### *Are there any restrictions on establishing a fund?*

Establishing a fund is regulated under the German Capital Investment Code (*Kapitalanlagegesetzbuch – KAGB*).

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### *What are common fund structures?*

Common form of funds include:

- Undertakings for Collective Investments in Transferrable Securities (UCITS); and
- Alternative Investment Funds (AIFs).

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### *What are the differences between offering fund securities to professional / institutional or other investors?*

A different set of rules apply under the German Capital Investment Code (*Kapitalanlagegesetzbuch – KAGB*) depending on whether you are marketing funds to retail investors or to professional/semi-professional investors. For all types of investors the marketing of a fund must be notified to and approved by the Federal Financial Supervisory Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin)*). When marketing to retail investors the fund managers generally need to provide the retail investor with more comprehensive information regarding the fund. There are specific rules as to the protection of retail investors, such as the right of revocation in certain scenarios.

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## *Are there any other notable risks or issues around establishing and investing in funds?*

### Establishing funds

Establishing a fund is regulated under the German Capital Investment Code (*Kapitalanlagegesetzbuch – KAGB*).

Managing investments is a regulated activity under the KAGB and therefore subject to authorization – pursuant to Section 339 KAGB providing the services of a fund manager without being authorized is a criminal offence punishable by imprisonment of up to five years.

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## Managing and marketing debt / hedge funds

### *Are there any restrictions on marketing a fund?*

Yes.

The marketing must comply with the detailed marketing rules set out in the German Capital Investment Code (*Kapitalanlagegesetzbuch – KAGB*). Generally, there are different rules with regard to the marketing of funds depending in particular on the type of fund, the type of investors and the domicile of the fund/fund manager.

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### *Are there any restrictions on managing a fund?*

Yes.

Alternative Investment Fund Managers (AIFMs) managers of Undertakings for Collective Investments in Transferable Securities (UCITS) are subject to regulation under the Capital Investment Code and must generally be authorized by the Federal Financial Supervisory Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht – BaFin*).

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## Entering into derivatives contracts

### *Are there any restrictions on entering into derivatives contracts?*

Yes.

Derivatives contracts are considered financial instruments under the German Banking Act (*Kreditwesengesetz – KWG*). Any person dealing in financial instruments can be subject to prior authorization by the Federal Financial Supervisory Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin)*) if such activity qualifies as banking business or a financial service.

The [European Market Infrastructure Regulation](#) (EMIR) generally applies to 'over-the-counter' derivative transactions (OTC-transactions) and requires that certain transactions are to be reported to the regulators and for transactions between counterparties to be cleared. Please note: The reporting obligation under Article 9 EMIR applies to all derivative transactions, regardless of whether the transaction is an OTC-transaction or a transaction carried out on an exchange venue.

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### *What are common types of derivatives?*

Types of derivative contracts that are used in Germany include, among others:

- forwards;

- futures;
- swaps (such as interest rate or currency swaps); and
- options (call options and put options).

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### *Are there any other notable risks or issues around entering into derivatives contracts?*

Derivatives and particularly over-the-counter derivatives have attracted significant regulatory attention in recent years. The European Commission has sought, in particular, to:

- enhance transparency by requiring the provision of comprehensive information on over-the-counter derivative positions;
- reduce counterparty risk by increasing the use of central counterparty clearing; and
- improve the management of operational risk by increasing the standardization of derivatives contracts.

As a result, the derivatives market has seen and continues to see the introduction of a significant amount of new regulation.

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## Debt finance

### Lending and borrowing

#### *Are there any restrictions on lending and borrowing?*

##### Lending

Lending business is qualified as licensable banking business and subject to prior authorization by the Federal Financial Supervisory Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin)*).

##### Borrowing

Borrowing does not constitute a regulated activity in Germany.

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#### *What are common lending structures?*

Lending in Germany can be structured in a number of different ways to include a variety of features depending on the commercial needs of the parties.

A loan can either be provided on a bilateral basis (a single lender providing the entire facility) or syndicated basis (multiple lenders each providing parts of the overall facility).

Syndicated facilities by their nature involve more parties (such as agents and trustees which fulfil certain roles for the finance parties), are more highly structured and involve more complex documentation. Larger financings will typically be done on a syndicated basis with one of the syndicate taking the lead in coordinating and arranging the financing.

Loans will be structured to achieve specific objectives, eg term loans, working-capital loans, equity bridge facilities, project facilities and letter of credit facilities.

A peculiarity in German law is the *Schuldscheindarlehen* – a specific financial instrument with a hybrid structure which sits between debt securities and bilateral/syndicated bank loans. *Schuldscheindarlehen* refers to an underlying loan agreement for which a separate

borrower's note (ie *Schuldschein*) as documentary evidence of the loan debt is usually issued. *Schuldscheindarlehen* are exempt from the obligation to publish a prospectus under European prospectus law. They enable borrowers to gain access to institutional capital markets investors that usually cannot be reached via other bank financings. See the [LMA Schuldschein Product Guide](#) published by the [Loan Market Association](#) (LMA) for more information.

## Loan durations

The duration of a loan can also vary between:

- a term loan, provided for an agreed period of time but with a short availability period;
- a revolving loan, provided for an agreed period of time with an availability period that extends nearer to maturity of the loan and which may be redrawn if repaid;
- an overdraft, provided on a short-term basis to solve short-term cash flow issues; or
- a standby or a bridging loan, intended to be used in exceptional circumstances when other forms of finance are unavailable and often attracting a higher margin.

## Loan security

A loan can either be secured, unsecured or guaranteed. For more information, see [Giving and taking guarantees and security](#).

## Loan commitment

A loan can also be:

- committed, meaning that the lender is obliged to provide the loan if certain conditions are fulfilled; or
- uncommitted, meaning that the lender has discretion whether or not to provide the loan.

## Loan repayment

A loan can also be repayable on demand, on an amortizing basis (in instalments over the life of the loan) or scheduled (usually meaning the loan is repayable in full at maturity).

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## What are the differences between lending to institutional / professional or other borrowers?

Lending to institutional/professional borrowers is subject to less regulatory oversight and so less burdensome from a compliance perspective.

By contrast, lending to consumers is a regulated activity and subject to special requirements for consumer credit agreements pursuant to section 491 et seq. of the German Civil Code (*Bürgerliches Gesetzbuch – BGB*), regarding, for example, the written form, minimum content, information obligations of the lender and right of withdrawal of the borrower.

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## Do the laws recognize the principles of agency and trusts?

The principle of agency is recognized under German law. For instance, it is possible to appoint an agent to act on behalf of other parties.

The English common law concept of trust is not recognized as a matter of German law. However, the same effect of a trust is achieved through the use of a similar German law legal instrument, namely a *Treuhand* which creates a contractual fiduciary relationship. Hence, in a finance transaction the security can be held by a security agent for the benefit of the secured parties as trustee under German law (*Sicherheitentreuhänder*) on similar conditions as a English common law trust. Particular provisions are required with respect to accessory security interests. (For more information, see [Giving and taking guarantees and security](#).) Please note that, in order to minimize

insolvency risks, the payment streams have to be checked on a case-by-case basis as the German *Sicherungstreuhand* does not, in contrast to an English common law trust, create a separate legal estate.

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## *Are there any other notable risks or issues around lending?*

### Generally

Loan agreements and other finance documents are subject to general contractual principles, such as:

- the general civil law principle of good faith (*Treu und Glauben*);
- the general civil law principle prohibiting violation of good morals (*gute Sitten*);
- usury (*Wucher*); and
- the prohibition of compound interest (*Zinseszinsverbot*) under German law.

### Standard form documentation

Most German law syndicated finance transactions are governed by documentation based on the German law versions of the recommended forms published by the [Loan Market Association](#) (LMA) in the English language. Bilateral finance transactions are more likely to be documented on bank standard form documentation prepared in-house in German language. Sometimes, the standard documentation developed by the Association of German Banks ([Bundesverband deutscher Banken](#)) is used.

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## *Are there any other notable risks or issues around borrowing?*

Borrowers should be aware of the potential implications of the EU's [Bank Recovery and Resolution Directive](#) (BRRD), which outlines certain measures for dealing with failing financial institutions.

The BRRD applies to financial institutions incorporated in the European Economic Area (EEA), but does not apply to EEA branches of non-EEA incorporated entities.

Article 55 of the BRRD gives authorities the power to 'bail in' obligations of failed EEA financial institutions and also postpone the enforcement of early termination rights against the affected institution. 'Bail in' describes a variety of write down and conversion powers, such as the power to convert certain liabilities into shares or cancel debt instruments. In the case of English or other EEA law contracts, such powers override what the contracts says. In the case of non-EEA law contracts, there are requirements to incorporate such provisions into the contract.

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## Giving and taking guarantees and security

### *Are there any restrictions on giving and taking guarantees and security?*

Some of the key areas affecting the giving of guarantees and security are as follows.

### Insolvency

Under German insolvency laws the fulfilment of a debt, the granting of collateral or enabling a counterparty to obtain such fulfilment or collateral may be contested by the insolvency administrator if the guarantee or security was granted by a company within certain periods of time (suspect periods) prior to the filing of insolvency proceedings against such company. This would be the case if, for example, the granting of collateral was made during the three months prior to the request to open insolvency proceedings, the company was illiquid on the date of the transaction, or the creditor was aware of his insolvency on this date (section 130 of the [German Insolvency Act](#) (



*Insolvenzordnung*)). Awareness of circumstances indicating insolvency or to a request to open insolvency proceedings are deemed equivalent to awareness of insolvency or of the request to open insolvency proceedings. Guarantees and security may also be challenged on other grounds relating to insolvency. Outside of insolvency proceedings, transactions and payments of the company may be contested by creditors under the Avoidance of Transactions Act (*Gesetz über die Anfechtung von Rechtshandlungen eines Schuldners außerhalb des Insolvenzverfahrens – AnfG*) which provides rights to creditors similar to those of an insolvency administrator in insolvency proceedings.

## Financial assistance/upstream security

Pursuant to German statutory law on capital maintenance requirements, a limited liability company (*Gesellschaft mit beschränkter Haftung* – GmbH) may, in general terms, only grant upstream security to its shareholders to the extent it has free reserves in its balance sheet. Free reserves are roughly equal to the total assets minus total liabilities and provisions, minus stated share capital. The principle also applies to the general partner in a partnership in the form of a GmbH and Co. KG. A stock corporation (*Aktiengesellschaft* – AG) may not grant upstream security at all. Exemptions apply under domination and profit transfer agreements and to payments which are covered by a full claim to counterperformance or restitution against the shareholder. In order to achieve compliance with the relevant statutory law, so called 'limitation language' has to be introduced in the relevant finance documentation.

## Accessory security interests

Accessory security interests that depend on the existence of the underlying secured claim, such as guarantees and pledges must be granted to and held by each secured creditor and are automatically terminated and released by operation of mandatory German law upon satisfaction of the underlying secured claim. This can be an issue in certain cases, for example syndicated loans or, in case of the transfer of a lender's rights and obligations under a loan agreement, by way of novation. For such cases parallel debt structures have been established by the market.

## Parallel debt structure

Non-accessory security interests (that exist irrespective of a secured claim, such as security assignment, security transfer or land charge) can be held by a security agent for the benefit of the secured parties as trustee under German law (*Sicherheitentreuhänder*). For more information, see [Lending and borrowing](#).

With respect to accessory security interests, such as guarantees and pledges, the standard technique used for sharing security between various creditors under syndicated loans is by the use of a parallel debt structure. With this structure, a second claim is created for the benefit of the security agent as an abstract acknowledgment of debt in the amount of the original payment obligations under the loan agreement (Parallel Debt). As the creditor of the Parallel Debt, the security agent can then hold and administer the accessory security. Provisions in an inter-creditor agreement or collateral agency agreement usually stipulate that the security agent acts on the instructions of the other secured parties. Please note that, although the Parallel Debt structure is commonly used in the market and generally accepted in German legal doctrine, its validity has never been tested by the German courts.

## Floating charges

The concept of a floating charge is not recognized as a matter of German law.

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## What are common types of guarantees and security?

### Common forms of guarantees

Guarantees may take the form of a performance guarantee or a payment guarantee. The most common form in finance transactions is the payment guarantee.

German law further distinguishes between an accessory guarantee and an independent (non-accessory) guarantee, such as payment guarantees upon first demand. German courts held that, to be valid, a guarantee upon first demand needs to be granted by a guarantor experienced in international transactions and familiar with guarantees upon first demand. This is due to the fact that a guarantor giving a guarantee upon first demand has only limited defenses, for example the objection of abuse of law. In contrast, a guarantor who gives an accessory guarantee may rely on the defenses to which the principal debtor is entitled.

## Common forms of security

The security package which is granted for financings mainly depends on the financed asset and the specific transaction. Typically, the following security interests are requested by the lenders:

### SHARE/INTEREST PLEDGE

A pledge of shares in a German limited liability company (*Gesellschaft mit beschränkter Haftung* – GmbH) requires notarization whereas a pledge over interests in a limited partnership (*Kommanditgesellschaft* – KG) can be entered into in simple written form. A pledge over shares in a stock corporation (*Aktiengesellschaft* – AG) may also be completed without observing specific formalities; only the share certificates issued for the relevant shares need to be transferred to the pledgee. The notification of the relevant company/partnership is not required for the perfection of the security. However, the articles of association of a company may provide for the requirement of the company's approval. As an accessory security interest, the share/interest pledge must be granted to and held by each secured creditor. Therefore, a parallel debt structure is usually implemented in syndicated financings. For more information, see [Lending and borrowing](#).

### BANK ACCOUNT PLEDGE

The notification of the account bank is required for the perfection of the security. The account bank usually has a first ranking pledge pursuant to its general business terms; if the lending bank wishes to obtain a first ranking security, the account bank then may be asked to waive/subordinate its rights pursuant to its general business terms. Security must be granted to and held by each secured creditor. Therefore, a parallel debt structure is usually introduced in syndicated financings. For more information, see [Lending and borrowing](#).

### SECURITY ASSIGNMENT OF RECEIVABLES AND CLAIMS

Unless disclosed to the debtors of the assigned receivables (third party debtors), the debtor may continue to pay with discharging effect to the assignor. The notification of the assignment is no perfection requirement, but common where there are only a small number of third party debtors (eg with respect to claims under insurance agreements).

### SECURITY TRANSFER OF MOVEABLE ASSETS (SUCH AS INVENTORY AND EQUIPMENT)

It is very important to describe the assets precisely, for example by using maps or serial numbers, in order to ensure their determinability when acquired (particularly in relation to future assets) or enforced. Typically, the specification of transferred assets is done by a combination of describing the area where the assets are located and by delivery of a list of the relevant assets. If the assets are fixtures (ie they relate to the relevant premises in such a way that they cannot be legally separated from the premises) then land security should be obtained.

### MORTGAGE OR LAND CHARGE OVER LAND AND BUILDINGS

A mortgage or land charge must be created by notarized deed. In addition, the registration of the mortgage or land charge in the relevant land register (*Grundbuch*) is required for its effectiveness. The notary and registration fees depend on the nominal amount and may be significant.

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## Are there any other notable risks or issues around giving and taking guarantees and security?

### Giving or taking guarantees

In order to be valid, a guarantee upon first demand must be granted by a guarantor experienced in international transactions and familiar with guarantees upon first demand. This is because the guarantor of a guarantee upon first demand has only limited defenses. For more information, see [Giving and taking guarantees and security – common types](#).

### Giving or taking security

#### NOTARIZATION REQUIREMENTS

The following security interests require notarization under German law:

- a pledge over shares in a German limited liability company; and
- the creation of a mortgage or land charge.

#### REGISTRATION REQUIREMENTS

A mortgage or land charge must be registered in the relevant land register (*Grundbuch*) to become valid.

#### INITIAL AND SUBSEQUENT OVER-COLLATERALIZATION

In case of an initial disproportionate relationship between the value of the granted security and the secured claims (initial over-collateralization), the agreement creating such security may be invalid. If, after the conclusion of the agreement (subsequent over-collateralization), the value of the security exceeds 110% of the secured claims, the grantor may have a claim for release of the excess security.

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## Financial regulation

### Law and regulation

*What are the main laws and regulations that apply to entities that are involved in finance and investments generally?*

#### Generally

German Banking Act (*Kreditwesengesetz – KWG*)

Securities Trading Act (*Wertpapierhandelsgesetz – WpHG*)

Payment Services Supervision Act (*Zahlungsdienstaufsichtsgesetz – ZAG*)

#### Consumer credit

German Civil Code (*Bürgerliches Gesetzbuch – BGB*)

Introductory Act to the Civil Code (*Einführungsgesetz zum Bürgerlichen Gesetzbuche – EGBGB*)

#### Mortgages

German Civil Code (*Bürgerliches Gesetzbuch – BGB*)

#### Corporations

Stock Corporation Act (*Aktiengesetz – AktG*)

Limited Liability Companies Act (*Gesetz betreffend die Gesellschaften mit beschränkter Haftung – GmbHG*)

Commercial Code (*Handelsgesetzbuch – HGB*)

#### Funds and platforms

German Capital Investment Code (*Kapitalanlagegesetzbuch – KAGB*)

#### Other key market legislation

Bank Recovery and Resolution Directive (2014/59/EU) (recovery and resolution)

Capital Requirements Regulation (Regulation (EU) 575/2013) (capital requirements)

[European Market Infrastructure Regulation \(Regulation \(EU\) 648/2012\) \(derivatives\)](#)

[Market Abuse Regulation \(Regulation \(EU\) 596/2014\) \(market abuse\)](#)

[Markets in Financial Instruments Directive \(2004/39/EC\) \(financial instruments\)](#)

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## Regulatory authorization

### *Who are the regulators?*

The Federal Financial Supervisory Authority ([Bundesanstalt für Finanzdienstleistungsaufsicht – \(BaFin\)](#)) and the [Deutsche Bundesbank](#) share banking supervision in Germany.

Pursuant to Section 6 para 1 of the German Banking Act (*Kreditwesengesetz* (KWG)), BaFin is the administrative authority responsible for the supervision of institutions under the Banking Act. The cooperation between BaFin and the Deutsche Bundesbank is governed by Section 7 of the German Banking Act (*Kreditwesengesetz* (KWG)), which stipulates that, among other things, the Deutsche Bundesbank shall, as part of the ongoing supervision process, analyze the reports and returns that institutions have to submit on a regular basis and assess whether their capital and risk management procedures are adequate.

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### *What are the authorization requirements and process?*

A firm must apply for authorization to the Federal Financial Supervisory Authority ([Bundesanstalt für Finanzdienstleistungsaufsicht – \(BaFin\)](#)). The BaFin will assess whether a firm meets the requirements set out in the German Banking Act (*Kreditwesengesetz – KWG*) including, for example capital requirements and organizational requirements.

The BaFin must assess the application within a period of six months from the submission of the complete application for authorization.

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### *What are the main ongoing compliance requirements?*

Threshold conditions, such as having adequate financial resources and compliance arrangements in place, are an ongoing compliance requirement for authorized firms.

Failure to comply with the threshold conditions and more detailed regulatory rules may result in sanctions for firms and regulated individuals, and loss of regulated status.

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### *What are the penalties for failure to be authorized?*

A person undertaking a regulated activity without being authorized or exempt, commits a criminal offence and is liable to imprisonment of up to five years.

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## Regulated activities

### *What finance and investment activities require authorization?*

#### Generally



A person must not carry on a regulated activity in Germany unless authorized or exempt.

A financial activity generally requires regulatory authorization when it either qualifies as banking business (eg deposit taking business) or the provision of financial services (eg the provision of investment advice).

## Consumer credit

Credit business generally qualifies as licensable banking business and requires prior authorization by the Federal Financial Supervisory Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht – BaFin*).

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## Are there any possible exemptions?

Activities that are otherwise regulated may be undertaken without authorization if general or specific exemptions are available.

## General exclusions

Certain persons may carry on a regulated activity without being authorized if they are granted an exemption granted by the Federal Financial Supervisory Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin)*).

## Specific exclusions

For certain types of regulated activities specific exemptions can apply, for example:

- for undertakings whose sole financial service within the meaning of section 1 para 1a sentence 2 of the German Banking Act (*Kreditwesengesetz – KWG*) comprises carrying out financial leasing activities, if they act only as an asset-leasing vehicle for a single leased asset, do not make their own business policy decisions and are managed by an institution domiciled in an EEA state which is authorized to conduct financial leasing operations under the laws of the home member state; and
- for undertakings whose sole financial service within the meaning of section 1 (1a) sentence 2 of the German Banking Act (*Kreditwesengesetz – KWG*) is dealing in foreign notes and coins, unless their principal activity is foreign currency dealing.

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## Do any exchange controls or other restrictions on payments apply?

Compliance with the Foreign Trade and Payments Ordinance (*Außenwirtschaftsverordnung – AWV*) must be ensured.

Where money is being transferred from non-EU member states, imports of foreign currency may need to be declared in customs declarations.

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## What are the rules around financial promotions?

Financial promotions of banks or investment firms must comply with the rules set out in the German Banking Act (*Kreditwesengesetz KWG*) and the Securities Trading Act (*Wertpapierhandelsgesetz – WpHG*).

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## Entity establishment

### What types of legal entity are generally used to undertake financial or investment activity?

Banks and financial services providers are usually established as German entities in the form of a private company limited by shares (*Gesellschaft mit beschränkter Haftung* – GmbH) or a public company limited by shares (*Aktiengesellschaft* – AG) and, in some cases, as a limited liability partnership (GmbH and Co KG).

To the extent Special Purpose Vehicles are set up for a certain transaction, they are usually established as a GmbH or a GmbH and Co KG.

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## *Is it possible to conduct lending or investment business through a branch or establishment?*

Yes.

Firms authorized by the Federal Financial Supervisory Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht* (BaFin)) in Germany can establish branches in Germany.

Certain firms that are authorized in other EEA-member states may rely on the European passport regime when establishing a branch in Germany.

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## FinTech

### FinTech products and uses

#### *What are the most common technology products and FinTech applications used or being developed in the finance and investment marketplace?*

##### Blockchain

Blockchain provides a new approach to holding and authenticating data. It is a database operating through distributed ledger technology in which data is recorded on computers, by way of a peer-to-peer mechanism, based on pre-agreed consensus algorithms in the applicable participating network. It is a form of database where data is stored in the chain in either fixed structures called 'blocks' or algorithm functions called 'hashes'.

Each block includes unique features such as its unique block reference number, the time the block was created and a link back to the previous block. Each block is reviewed by a number of nodes and the block is only added to the database if the node reaches consensus that the block only contains valid transactions. Content includes digital assets and instructions which reflect the transactions and parties to those transactions. The ability to track previous blocks in the chain makes it possible to identify transactions back to the first ever transaction completed, enabling parties to verify and establish the authenticity of the assets in the latest block.

Specialist users on the system apply advanced computing software to identify time stamped blocks, verify the accuracy of the block using sophisticated algorithms and add the verified block to the chain. As the number of participants increases, the replication of the data over a wider base makes it harder for any person to alter the data in the chain. Any attempted addition or modification to the information on a block needs to be approved by all users in the network and verification of any block can only happen through a 'proof of work' process.

Blockchain is a decentralized system, created and maintained by users of the network rather than being dependent on any central or third party intermediary. It may be public and open ('permissionless' or 'unpermissioned') or structured within a private group ('permissioned').

Permissionless blockchains include bitcoin and ethereum, in which anyone can set up a node that once authorized, can validate, observe and submit transactions. The identities of the participants are not known (other than the unique and random identities known as an 'address'). Permissioned ledgers restrict participation in the network and only the specific participants are given access and are known within the network. The network is private, and only organizations that have been authorized can participate and view transactions.

##### Smart contracts

Developments in blockchain are also providing an ability to transfer and rely on instructions verified within the electronic system in the form of so called 'smart contracts'. These contracts have been converted into code and are then executed and enforced by the blockchain network on the occurrence of an event. This reduces the need for intermediaries to collect, store and act on communicated information.

Smart contracts are essentially pre-written computer codes which are stored and replicated on distributed ledger platforms such as blockchain. Execution takes place over the network, eliminating the need for intermediary parties to confirm the transaction, leading to self-executing contractual provisions. These contracts can be as simple as moving a balance from one account to another or advanced, more-complex interactions with the outside world using so called 'Oracles'. With Oracles, the contract code consults with a service outside of the blockchain network to make a decision. This may entail receiving a confirmation that an event has occurred, such as payment, which automatically executes a further step in the contract, such as the transfer of an asset, which might be in digital form or by delivering instructions to a person or warehouse to release the asset for delivery.

## Artificial intelligence and robo advisory systems

Automated financial advice tools, also known as 'robo advisors', are software tools driven by artificial intelligence (AI) that provide a variety of investment advice services, from portfolio selection to personal finance planning. The systems are generally operated on a platform /personal dashboard basis; a user can input a set of personalized data to be processed by the AI algorithms which produce optimized outcomes around specified parameters.

## Cloud computing

Cloud computing enables delivery of IT services through internet-based tools and applications, rather than direct connection to a physical server. Cloud-based storage makes it possible to save masses of data to remote servers, accessible through the internet rather than by way of a physical connection.

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## *Are there any restrictions, specific laws, regulations or procedures that apply to FinTech products?*

### General financial regulatory regime

The Federal Financial Supervisory Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht* or BaFin), and the Deutsche Bundesbank are the regulatory authorities in Germany with respect to firms providing banking or financial products and services.

A person must not carry out a regulated activity in Germany unless authorized or exempt under the German Banking Act or the Payment Services Supervision Act. Where FinTech products or applications involve any financial activity which requires regulatory authorization, the firms providing such products or applications must obtain such authorization prior to commencing their regulated business activity. Carrying out regulated activities without the necessary authorization is a criminal offence.

The BaFin has published guidance for FinTech companies, in particular as to the question of whether certain business activities (eg crowdlending, crowdinvesting or robo advice) require a license in Germany.

### Banks and financial services providers

Any FinTech provider that either conducts banking business or provides financial services must obtain a prior written authorization under the German Banking Act.

### Regulation of payment services

Payment services providers are regulated under the Payment Services Supervision Act and require a prior written authorization by the BaFin for carrying out payment services.

### Application of data protection and consumer laws

FinTechs dealing with consumers must comply with all relevant consumer protection laws (eg in relation to information obligations). FinTechs must also comply with the applicable data protection legislation, in particular if they come in contact with any personal data.

## Money laundering regulations

Generally, where a firm is authorized as either a financial institution or a payment services provider it will need to comply with the regulations on money laundering, in particular with the requirements set out in the German Money Laundering Act.

*Last modified 20 Oct 2017*

## *What type of funding arrangements and incentives are available to FinTech businesses?*

There are numerous options available to FinTechs with respect to funding their businesses, including the following.

### Crowdfunding

There are two main types of crowdfunding: equity and reward-based.

- Equity crowdfunding involves company shares being given in exchange for investment in the business.
- Reward-based crowdfunding provides investors with a tangible benefit, such as early access to a platform or application that the business is developing.

### Venture capital

Venture capital (VC) funding is a type of equity investment usually targeted at early stage FinTech companies. VC provides an alternative to traditional lending in particular in scenarios where the business is unlikely to have the tangible asset base or long track record needed to attract traditional debt funding from financial institutions.

### Bank debt

Bank finance may be particularly important for working capital, overdraft, accounts management and general liquidity purposes.

### Capital markets funding

An Initial Public Offering (IPO) can be a viable option for FinTech companies that have grown to a certain size. An IPO is the initial sale of company shares on a public exchange.

FinTech companies can also issue bonds to investors as a way of raising more competitive funding.

*Last modified 20 Oct 2017*

## Portfolio sales

### Loan transfers and portfolio sales

#### *What are common ways of buying and selling loans?*

Buying and selling loans is very common.

A loan can be sold on an individual basis or packaged up with other loans and sold as a portfolio pursuant to overarching terms.

The most common ways of selling and transferring loans are:



- **Assignment and Assumption of Contract (*Vertragsübernahme*)** – A *Vertragsübernahme* is a full legal transfer of a party's rights and obligations. It is a tripartite arrangement between the existing parties and the transferee and results in a continuation of the existing contract between the continuing party and the transferee and the transferor being released from its obligations.
- **Assignment** – An assignment is a transfer of rights only, not obligations. Subject to any contractual restrictions, assignment can be done without the consent of the debtor. Assignments may be done on a silent basis or on a disclosed basis. If disclosed, payments by the debtor to the assignee have releasing effect.
- **Sub-participation** – A sub-participation is a transfer of the economic interest in a loan without changing the legal relationship between the existing parties. Sub-participations involve the buyer taking on double credit risk, both on the seller as well as the borrower.

Loan transfers are commonly documented using standard form contracts in Germany based on the Federal Association of Loan Purchase and Servicing (*Bundesvereinigung Kreditankauf und Servicing e.V. – BKS*) standards. For more complex transactions, a more bespoke form of sale and purchase agreement would tend to be used.

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## *What are the main considerations when transferring a loan and related security?*

There are a number of issues to consider before transferring a loan or portfolio of loans. These issues are often covered as part of a due diligence exercise by the seller's legal advisors. Some of the key considerations include:

- **assignability** – whether the loans and security can be transferred or are subject to contractual or legal restrictions;
- **registration of land charges** – whether land charges (if this type of security is part of the security package) are duly registered and serve the correct security purpose;
- **parallel debt** – if the loan and security can be independently demanded by a security trustee, whether a valid parallel debt structure is in place that secures accessory security against extinguishment if transfers of the loan have to be made under a different jurisdiction's law, for example novation under English law;
- **confidentiality** – whether the seller of the loan is allowed to disclose information relating to the loan to a potential purchaser;
- **data protection** – whether there is any personal data or other restricted information in the loan that should not be disclosed to a potential purchaser;
- **lender eligibility** – whether there are any restrictions regarding the type of entity to which the loan can be transferred;
- **undrawn commitments** – whether there are any continuing obligations for further funding or other material obligations on the part of the lender that may fall on the transferee or reduce claims made by the transferee;
- **transfer mechanics** – whether there are any steps required to be taken in order to transfer the loan in accordance with its terms; and
- **consent** – whether a transfer requires the consent or notification of any other parties.

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## Projects

### Financing / investing in energy / infrastructure

#### *To what extent are energy and infrastructure assets publicly or privately owned?*

The gas and electricity industries in Germany are privatized, with the generation/production, transmission, distribution and supply provided by various private sector companies. Accordingly, relevant infrastructure assets used for generation/production, transmission and distribution are owned by private sector companies. However, at a regional level, municipal utilities (such as public law companies or private law entities in majority held by municipalities) may provide utility services under a public service mission and therefore may also own energy infrastructure assets.

Motorways and roads are almost exclusively owned by the state, either by the Federal Republic of Germany (eg the motorways), or the relevant *Bundesländer*, municipal entities etc. Very few roads are privately owned. The same is true for other traffic assets (tunnels etc).

The major German rail company, *Deutsche Bahn*, is organized as a stock exchange company, but all stock is held by the Federal Republic of Germany. Other smaller rail companies exist which are, however, private entities.

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## *Are there special rules for investing in energy and infrastructure?*

Energy and infrastructure markets in Germany are highly regulated by European and national legislation and also by decisions of the German regulatory authority, the German Federal Network Agency (*Bundesnetzagentur*). This especially holds true for the operation of electricity or gas networks. In particular, network operators are not entitled to freely determine tariffs for the transportation of energy but need to comply with regulatory requirements relating to tariffs (which will, however, still provide for considerable incentives for investments). Accordingly, investors will need to have a good understanding of the applicable regulatory framework and, due to regularly changes to the regulatory framework, will also need to take into account potential directions in which the market may move.

Investors will also need to be aware that energy markets are subject to a complex system of contractual arrangements between generators/producers/importers, suppliers, purchasers, network and storage operators and also the relevant person conducting balancing services for the injection of energy in the network and the withdrawal from the network. The contractual agreements in relation to network access are highly regulated and therefore will generally not leave much room for negotiation between market participants.

Furthermore, under European and national unbundling provisions effective separations of networks from activities of generation /production and supply of energy are required in order to avoid discriminatory effects. Accordingly, where an investor is already active in the area of generation/production or supply, he will only be able to invest in network facilities in compliance with strict unbundling provisions and *vice versa*.

Various other regulatory provisions and limitations exist for other infrastructure assets, such as telecom assets or roads.

Where essential security interests of the Federal Republic of Germany would be affected by the acquisition of the shares of a German entity or infrastructure assets, a foreign investor would also need to take into account statutory requirements under the German Federal Act on Foreign Trade (*Außenwirtschaftsgesetz – AWG*). In particular, such acquisition may be subject to notification requirements and the objection of German authorities.

*Last modified 20 Oct 2017*

## *What is the applicable procurement process?*

Public procurement in Germany is governed by a variety of federal acts based on a triad of EU Directives which were modernized in 2014. On 18 April 2016, the modernized European procurement law was enacted into German law and has, in some respects, brought material changes. In relation to energy and infrastructure, the Regulation on the Award of Public Contracts (*Vergabeverordnung – VgV*) and the Regulation on the Award of Contracts in the field of Sectors (*Sektorenverordnung – SektVO*) apply. Whereas the VgV is more general in nature and therefore contains provisions for procurements not being addressed by the SektVO, the SektVO provides specific regulations for contracts in the water, electricity, energy and transportation sectors. Furthermore, there are special statutes on procurement of concessions, construction services and defense and security-related contracts.

The key principles of German procurement law are that all contracts procured by the public sector or other so-called contracting authorities are awarded fairly, transparently and without discrimination on the grounds of nationality and that all potential bidders are treated equally.

## *Investing in energy and infrastructure*

Public procurement is relevant where a German contracting authority, such as the government or a sector entity, is seeking to outsource the delivery of a new project. For infrastructure projects, a potential investor would have to bid in its own capacity or as part of a consortium to deliver the overall deal, which could include: design; building; operation; maintenance and financing of the relevant energy or infrastructure asset. The relevant procurement legislation applies not only to certain public bodies including central government departments and local authorities but also to various non-governmental bodies, such as private entities in the various sectors. A

regulated procurement is required where certain financial thresholds are met and in most major infrastructure projects (where limited exclusions do not apply), it is likely that those thresholds will be met and therefore a regulated procurement would be necessary.

In most cases, the public sector will need to publish a contract notice in the Office Journal of the European Union (OJEU) and typically run one of the following procedures:

- **Open procedure** – This is suitable for easy-to-evaluate projects. Tenderers simply submit a tender in response to the OJEU notice. Change and negotiations to the tender are not permitted.
- **Restricted procedure** – There is a shortlisting of at least five tenderers following an expression of interest stage. Tenderers submit a bid. Again, no negotiation is permitted other than clarification and finalization of the contract terms.
- **Negotiated procedure with prior call for competition** – In negotiated procedures with prior call for competition, any economic operator may submit a request to participate in response to a call for competition. Only those economic operators invited by the contracting entity following its assessment of the information provided may participate in the negotiations. This is a hybrid procedure as it allows dialogue with bidders but also allows the public sector to award a contract on the basis of an initial tender (or further stages) but clarification and negotiation are not allowed following final tender.
- **Competitive dialogue** – The competitive dialogue involves a shortlisting of at least three bidders who are invited to enter into dialogue with the public sector to develop detailed solutions which are capable of being accepted by the public sector. Clarification and further negotiations are allowed following final tender but only on the basis of confirming the financial and other commitments in a tenderer's bid.

An investor may choose, however, to seek to invest in a project (by acquiring an interest in a private sector partner) that has already been procured and is operational. Typically, such investments are controlled by contractual mechanisms (particularly on publicly procured projects) within the originally awarded contract rather than procurement regulations themselves.

Depending on the structure of the deal, any acquisition of an interest in or variation to the existing project may have procurement-related considerations that need to be borne in mind since they might cause a new procurement procedure.

## Financing energy and infrastructure

On a publicly procured contract, the public sector may have prescribed requirements on the funding arrangements. Following entry into the contract, the main tool for controlling the financing is that, typically, in project finance deals, a refinancing of the senior debt will require the consent of the public sector.

*Last modified 20 Oct 2017*

## *What are the most common forms of funding / investing in energy and infrastructure?*

As various regulatory restrictions exist, investing into the equity of an energy or infrastructure project may require in depth legal regulatory advice. Beyond these particularities, funding and investing in energy and infrastructure in Germany follows the European standard:

### Funding

Common forms of funding in energy and infrastructure include:

- loans made on a corporate finance basis (balance sheet debt);
- loans made on a project-finance basis (to a special purpose project company) on medium- to long-term bases – such loans may later be syndicated to other funders;
- bond finance (less common in Germany than in the UK, but could become more popular in the future);
- mezzanine debt (rarely seen since the financial crisis, but in theory an alternative);
- refinancing of the debt in operational projects; and
- asset financing (this is particularly relevant in the rail sector).

Following the global financial crisis, the German government has tried to expand the funding base and increase liquidity in the market by increasing the KfW funding program for renewable energy projects with a German element to them.

Funding provided by the European Investment Bank and export credit agencies is also very popular in the German market.

## Investing

Common forms of investing in energy and infrastructure include:

- 'equity' investment in special purpose vehicles or entities that may have a portfolio of interests, ie share capital and subordinated sponsor loans; and
- secondary market investment in operational projects (acquisition of 'equity').

*Last modified 20 Oct 2017*

## Restructuring

### Enforcement and sanctions

#### *When can there be regulatory investigations?*

The Federal Financial Supervisory Authority ([Bundesanstalt für Finanzdienstleistungsaufsicht – BaFin](#)) can – without any particular reason – perform statutory audits.

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#### *What regulatory penalties may apply?*

Failure to comply with the requirements of the German Banking Act ([Kreditwesengesetz – KWG](#)) and other regulatory rules may result in sanctions for firms and certain individuals (eg directors). The Federal Financial Supervisory Authority ([Bundesanstalt für Finanzdienstleistungsaufsicht – BaFin](#)) can also revoke a firm's authorization.

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#### *What criminal penalties may apply?*

A person undertaking a regulated activity without being authorized or exempt, commits a criminal offence and is liable to imprisonment of up to five years.

There are further criminal penalties, eg for market abuse and for money laundering.

*Last modified 20 Oct 2017*

## Tax

### Tax issues

#### *Are stamp, registration, transfer or other similar taxes applicable?*

Are there stamp, registration, transfer or other similar taxes payable on the advance, transfer or assignment of a loan?



There are no stamp, registration, transfer or other similar taxes payable on the advance, transfer or assignment of a loan.

### **Are there stamp, registration, transfer or other similar taxes payable on the taking, transfer or assignment of a mortgage, debenture or other security?**

There are no stamp, registration, transfer or other similar taxes payable on the taking, transfer or assignment of a mortgage, debenture or other security.

### **Are there stamp, registration, transfer or other similar taxes payable on the issue, transfer or assignment of a debt security (eg a bond)?**

There are no stamp, registration, transfer or other similar taxes payable on the issue, transfer or assignment of a debt security.

*Last modified 20 Oct 2017*

### ***Do tax authorities take priority on enforcement?***

#### **On the enforcement of security, do tax authorities take priority over secured lenders or secured debt security holders (eg secured bond holders)?**

The German tax authorities do not take priority over secured lenders or secured debt security holders on enforcement of security.

*Last modified 20 Oct 2017*

### ***Is withholding tax on interest payments applicable?***

#### **Is there withholding tax on interest payments under a loan?**

Provided that the borrower is not a bank or financial services provider, generally no withholding tax will be levied. Withholding tax may, however, apply in the case of a loan that qualifies as profit participating. Generally, a loan qualifies as profit participating if either the claim for interest generally, or its amount, depends on the profitability of the borrower's business or specific parts thereof.

**If so:**

#### **What is the rate of withholding?**

Where applicable, the rate of withholding is 25%.

#### **What are the key exemptions?**

Most German double tax treaties allocate the taxing rights on interest to the contracting state in which the lender resides, which means that, in most cases, there is a full exemption from German withholding tax. Otherwise, most German double tax treaties limit Germany's taxing rights to a withholding tax rate of 10%.

#### **Would the same analysis apply to interest payments under a debt security (eg a bond)?**

Yes.

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### ***Are foreign lenders and debt security holders subject to tax on interest payments?***

**Will the lender be taxed on interest payments under a loan in the jurisdiction of the borrower (other than by way of the application of withholding tax (if any)), assuming the lender is not otherwise resident in that jurisdiction for tax purposes (eg by virtue of incorporation, residence or local branch)?**

A lender which is not resident in Germany would only be subject to tax in Germany to the extent it receives German source income. German source income in this regard only includes interest paid on a:

- loan secured by real estate located in Germany or ships registered in a German register; and
- profit-participating loan.

Therefore, a lender which is not resident in Germany, would not be taxed on 'plain vanilla' interest income in Germany.

It should also be noted in this regard that most German double tax treaties exclude a German taxing right on interest payable or paid to a lender resident in the other contracting state (meaning that there is full exemption), and otherwise, most German double tax treaties limit Germany's taxing right to 10% withholding tax.

### Would the same analysis apply to interest payments under a debt security (eg a bond)?

Interest paid on a bond is generally not included in German source income. It is, however, included in German source income if:

- the bond is not held in a securities deposit account at the financial services provider paying out the interest; and
- the interest is paid on presentation of the respective interest coupon either in cash or by crediting such amount to an account of a person or entity that is not a bank or a financial services provider.

It should also be noted in this regard that most German double tax treaties exclude a German taxing right on interest paid or payable to a person resident in the other contracting state (meaning there is full exemption). Otherwise, most German double tax treaties limit Germany's taxing right to a withholding tax rate of 10%.

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