The Legal 500
Country Comparative Guides

Germany
LENDING & SECURED FINANCE

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This country-specific Q&A provides an overview of lending & secured finance laws and regulations applicable in Germany.
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1. Do foreign lenders require a licence/regulatory approval to lend into your jurisdiction or take the benefit of security over assets located in your jurisdiction?

Originating loans to German borrowers requires a licence under German law, a European passport or an exemption from German licence rules. No licence is required if a lender acquires fully drawn term loans (while certain changes to an existing loan may give rise to licence requirements, such as the extension of the maturity of a loan). Under particular circumstances foreign lenders may not require a licence when lending to German borrowers; this includes, inter alia, that lenders do not actively approach the German market.

2. Are there any laws or regulations limiting the amount of interest that can be charged by lenders?

There is no general rule limiting the amount of interest. However, interest may be regarded as excessive if it exceeds the interest rate charged in the market for that type of loan by more than 100 per cent. This restriction applies in exceptional cases only and there are very few cases known where this provision has been successfully invoked by a borrower party. Also, borrowers may not agree in advance to pay interest on interest, i.e. there is no automatic compounding of interest. However, it is possible that a borrower requests that interest, once due, is compounded. This is particularly relevant for facilities where interest (entirely or in part) is paid in kind. In practice parties would work with compounding notices and related drafting in the loan document.

3. Are there any laws or regulations relating to the disbursement of foreign currency loan proceeds into, or the repayment of principal, interest or fees in foreign currency from, your jurisdiction?

There are notification requirements for certain payments to foreign parties for statistical purposes. Additional restrictions may arise under EU/UN sanction rules. Other than that there are no such restrictions.

4. Can security be taken over the following types of asset: i. real property (land), plant and machinery; ii. equipment; iii. inventory; iv. receivables; and v. shares in companies incorporated in your jurisdiction.

Security over assets located in Germany may only be granted under German law governed documents. While under certain circumstances German law governed receivables may be assigned under a foreign law governed security agreement this is an option which is rarely made use of.

Security over real property is in practice granted through immediately enforceable land charges (with land charges being preferable towards mortgages). Immediately enforceable land charges are granted (in a German language document) by the security grantor in front of a notary public and subsequently filed with the land register. Plant and machinery are either forming part of the real property (and will, thus, be captured by the land charge) or are considered moveable assets (and security will be granted through a security transfer agreement which requires those moveable assets to be thoroughly identified, through asset lists, buildings and site maps or otherwise). Whether plant and machinery are captured by a land charge or require a separate transfer under a security transfer agreement depends on the prevailing circumstances of a particular site and the assets located on that site.

Security over equipment is taken through a written security transfer agreement which requires identification of the transferred assets either by way of reference to detailed building and site maps or lists setting out the
items of inventory in an identifiable manner, e.g. through its stock number. The agreement may be made in the English language.

Security over inventory is taken through a security transfer agreement, which needs to follow the same rules as set out for taking security over equipment.

Receivables are either assigned or (in less frequent cases) pledged, usually in written form, unless exceptional circumstances require notarisation. While an assignment is valid without notice to the third party debtor, it enhances the position of the secured parties if the assignment is notified to the third party debtor. Third party debtors of trade receivables are, for practical purposes, usually not notified. Unlike an assignment, the pledge over receivables (including bank accounts) requires the notification of each of the third party debtors for the pledge to be valid. The agreement may be made in the English language.

Shares are usually pledged under a share or stock pledge agreement. Shares in limited liability companies (and, in certain circumstances, partnership interests) are pledged under a pledge agreement which requires notarisation. Pledging stock in a stock corporation may be made in written form (i.e. without notarisation). Each of these agreements may be made in the English language.

5. Can a company that is incorporated in your jurisdiction grant security over its future assets or for future obligations?

Yes, provided that the relevant security agreements provide for the relevant provisions and the future assets and future obligations are sufficiently identifiable.

6. Can a single security agreement be used to take security over all of a company’s assets or are separate agreements required in relation to each type of asset?

Separate security agreements are usually used for taking security over individual types of assets. In particular cases it can, however, be desirable to integrate different types of security in one single agreement.

7. Are there any notarisation or legalisation requirements in your jurisdiction? If so, what is the process for execution?

Share pledge agreements for shares in limited liability companies and, in certain cases, interests in partnerships, require notarisation. The entirety of the agreement must be read by a notary public in front of each of the parties to the agreement (who may be present through attorneys in fact).

Immediately enforceable land charges (and mortgages) require to be notarised in front of a notary public (i.e. read out in front of the security grantor by a notary) and registered with the land registry.

8. Are there any security registration requirements in your jurisdiction?

There is no general registration requirement under German law.

However, land charges require registration in the land register.

Certain IP rights may be registered in the relevant IP registers, however this registration is sometimes only made prior to enforcement.

9. Are there any material costs that lenders should be aware of when structuring deals (for example, stamp duty on security, notarial fees, registration costs or any other charges or duties), either at the outset or upon enforcement?

The notarisation of share pledges and land charges and the registration of land charges with the land register incur considerable costs the amount of which depends, in case of the share pledges, on the higher of the (i) secured obligations and (ii) the value of the company the shares of which are being pledged. In case of the land charge, notarial fees and registration costs depend on the face value of the land charge. While notarial fees follow mandatory laws there are certain (legally permissible) techniques available to keep notary’s fees as low as possible.

10. Can a company guarantee or secure the obligations of another group company; are there limitations in this regard?

Yes, provided that for upstream and side-stream security (to holding and sister companies) certain restrictions apply (which are set out in the two following
paragraphs). Those restrictions do not have the effect to invalidate security but, if not adhered to, might cause the officers of the security grantor to be held personally liable.

Stock corporations may only grant upstream/side-stream security within strict boundaries, unless in an onlending situation, requiring the existence of a profit and loss transfer agreement with the major shareholder. In addition, stock corporations may not provide financial assistance (directly or indirectly) for the purchase of their own stock.

The rules applicable for providing upstream/side-stream security (collateral and guarantees) by limited liability companies require that payments to be made under a guarantee (or enforcement proceeds from the enforcement of collateral) do not exceed the security grantor’s free assets (i.e. the security grantor’s assets minus debt minus statutory share capital). To achieve that, agreements providing for the granting of upstream/side-stream security/guarantees usually contain limitation language which restricts the enforcement (in case of guarantees) or the distribution of enforcement proceeds (in case of asset security) to avoid officers being held personally liable. The details of the limitation language depends on a number of factors, such as the type of financing and management access to information.

11. Are there any issues that lenders should be aware of when requesting guarantees (for example, financial assistance or lack of corporate benefit)?

German law provides for a more general corporate benefit test, i.e. when granting security this must be in the interest of the relevant company. However, this is not a strict corporate benefit test (as known in other jurisdictions) which follows certain formal requirements on resolution and documentation of certain measures and their benefit for the company.

12. Are there any restrictions against providing security to support borrowings incurred for the purposes of acquiring shares: (i) of the company; (ii) of any company which directly/indirectly owns shares in the company; or (iii) in a related company?

A stock corporation may not provide financial assistance with respect to the purchase of its own stock. No such restriction, however, applies to limited liability companies (GmbHs) or partnerships, subject to the above mentioned restrictions on the granting of upstream/side-stream security.

13. Can lenders in a syndicate appoint a trustee or agent to (i) hold security on the syndicate’s behalf, (ii) enforce the syndicate’s rights under the loan documentation and (iii) apply any enforcement proceeds to the claims of all lenders in the syndicate?

(i) An agent or trustee can hold security on the syndicate’s behalf provided that in order to hold security which has been created by way of a pledge the agent or trustee would also need to have a corresponding payment claim against the security grantor or an obligor. In order to achieve that objective, the relevant finance documents provide for customary parallel debt language. (ii) An agent or trustee may enforce security on the syndicate’s behalf, which may require the agent/trustee to be furnished with a particular power of attorney for certain court proceedings. (iii) An agent or trustee may generally apply enforcement proceeds to the claims of all lenders in the syndicate.

14. If your jurisdiction does not recognise the role of an agent or trustee, are there any other ways to achieve the same effect and avoid individual lenders having to enforce their security separately?

German law does recognise agent and trustee roles, refer to answer 13 above to achieve the desired arrangement where there is a syndicate of lenders.

15. Does withholding tax arise on (i) payments of interest to domestic or foreign lenders, or (ii) the proceeds of enforcing security or claiming under a guarantee?

In general, German domestic tax law does not require the borrower to withhold taxes, provided (i) the borrower is not a domestic financial institution (including a domestic branch of a foreign institution), (ii) the loan is not profit-participating or otherwise qualifies as participatory debt and (iii) the loan is not securitized or acquired via an internet portal.

However, interest payments to foreign lenders on loans
which are directly or indirectly secured by German real estate (or heritable building rights or ships) are generally subject to tax under German domestic laws (regardless of whether the borrower is resident in Germany or not). In such cases, lenders are generally required to file a German tax return. Moreover, German tax authorities may require the borrower to withhold German income taxes owed by foreign lenders (usually at a rate of 15.825% for corporate taxpayers).

However, it should be noted that many tax treaties exclude Germany’s taxing right. If a foreign lender is protected by a treaty, it can apply for a refund of German withholding tax (should such tax have been deducted).

16. If payments of interest to foreign lenders are generally subject to withholding tax, what is the standard rate and what is the minimum rate possible under double taxation treaties?

Please see above.

17. Are there any other tax issues that foreign lenders should be aware of when lending into your jurisdiction?

In general, income of a foreign lender will not become taxable in Germany solely because of a loan to or guarantee and/or grant of security from a German company.

An exception may apply to interest payments to foreign lenders on loans which are secured by German real estate (or heritable building rights or ships). Such payments are subject to tax under German domestic laws (please see above), but Germany’s taxing right is frequently excluded under applicable tax treaties.

Moreover, the income of a foreign lender can become taxable in Germany if it is allocable to a German permanent establishment (including a permanent representative) of that lender.

18. Are there any tax incentives available for foreign lenders lending into your jurisdiction?

No (but in most cases, the interest payments received by foreign lenders are not subject to German tax, as set out above).

19. Is there a history in your jurisdiction of financing structures being challenged by tax authorities, and if so, can you give examples.

If Germany has the right to tax interest income (e.g. in case of profit-participating interest paid to foreign lenders) it cannot be ruled out that the German tax authorities will try to challenge financing structures that, for example, are designed to generate “white income” or a “double dip” and are based on qualification conflicts or questionable beneficial ownership situations.

Moreover, a draft bill for a so-called “Tax Haven Defense Act” has been published. Among others and subject to certain further requirements, the bill includes defense measures relating to business relations with non-cooperative jurisdiction listed in the so-called EU “black list”. Such defense measures include, for example, a prohibition to deduct business expenses in case of dealings with non-cooperative jurisdictions and rules for the taxation (including by way of withholding) of non-residents providing financing. If the draft bill is implemented, German-resident borrowers may be reluctant to deal with lenders resident in a black-listed jurisdiction.

Another draft bill for the implementation of the Anti-Tax Avoidance Directive includes, among others, rules to disallow the tax deductibility of business expenses arising from hybrid mismatch arrangements (in case of related party transaction or so-called “structured arrangements”).

20. Do the courts in your jurisdiction generally give effect to the choice of other laws (in particular, English law) to govern the terms of any agreement entered into by a company incorporated in your jurisdiction?

Yes, with certain customary exceptions, e.g. in the case of consumers.

21. Do the courts in your jurisdiction generally enforce the judgments of courts in other jurisdictions and is your country a member of The Convention on the Recognition and Enforcement of Foreign Arbitral Awards?

Yes, with certain customary exceptions, e.g. in the case of consumers.
22. **What (briefly) is the insolvency process in your jurisdiction?**

Proceedings commence with preliminary insolvency proceedings (which may be started on the application of creditors or the borrower's management). A preliminary insolvency administrator is appointed to administrate this process and also, in most cases, to take over the management of the insolvent company. Preliminary insolvency proceedings serve the purpose to assess whether a company is actually insolvent and whether there are sufficient assets available to cover the cost of insolvency proceedings.

Once this has been established, insolvency proceedings will commence and an insolvency administrator will be appointed by the insolvency court. Under the supervision of the court and under the control of the creditors (which may form a committee) the administrator will either sell the company as a going concern or liquidate individual assets. The goal of the insolvency proceedings is to fully satisfy the obligations of the insolvent company's creditors.

Insolvency proceedings will end once all assets have been liquidated and all proceeds from the liquidation have been distributed amongst creditors.

23. **What impact does the insolvency process have on the ability of a lender to enforce its rights as a secured party over the security?**

Land charges may generally be enforced also in insolvency proceedings (with few exceptions). The same applies to claims and shares which have been pledged to creditors.

Inventory, other moveable assets and receivables may be enforced by the administrator. The enforcement proceeds (minus an amount representing app. 11 per cent. of such proceeds to cover the administrator's cost) will be turned over to the secured creditors.

24. **Please comment on transactions voidable upon insolvency.**

Whether a transaction is voidable upon insolvency depends on a set of complex rules which look at the details of the transaction. While transactions which have been completed during the period of three months prior to the filing for insolvency are, as a general rule, more easily voidable, transactions which have been completed outside this three months period require either some element of knowledge on the side of the creditor (about circumstances which might give rise to an insolvency) or which involve an element of preferential treatment, e.g. the granting of additional security after a loan has been fully drawn. To address potential voidability risks it is important that (i) lenders establish the financial situation of the borrower when extending a loan, (ii) have security being put in place no later than within a two week period from funding and, (iii) where there are particular circumstances, choose a risk adverse transaction structure.

25. **Is set off recognised on insolvency?**

If a particular right of set off existed prior to the opening of insolvency proceedings then this right of set off will continue to exist in the insolvent company's insolvency. In case a right of set off arises after the opening of insolvency proceedings, set off may be restricted.

26. **Can you comment generally on the success of foreign creditors in enforcing their security and successfully recovering their outstandings on insolvency?**

Germany has a very stable enforcement regime and will generally not pay regard to a creditor's origin (i.e. whether it is a national or international creditor). There are multiple examples where foreign lenders have successfully enforced security, in and outside of insolvency.

Enforcement of collateral in Germany requires careful planning as the right strategy will have a considerable impact on timing and recovery.

27. **Are there any impending reforms in your jurisdiction which will make lending into your jurisdiction easier or harder for foreign lenders?**

No such reform plans are known.

28. **What proportion of the lending provided to companies consists of traditional bank debt versus alternative credit providers (including credit funds) and/or capital markets, and do you see any trends emerging in your jurisdiction?**

The role of alternative credit (e.g. credit funds, insurance companies) has increased considerably in recent years.
In particular in the acquisition finance, real estate finance and asset based lending space there is a growing amount of alternative credit available and the number of actual transactions where funding has been provided through alternative sources of credit has increased.

29. Please comment on external factors causing changes to the drafting of secured lending documentation and the structuring of such deals such as (i) Brexit (ii) LIBOR transition and/or (iii) COVID 19

In relation to BREXIT, we do see an increasing number of transactions where bail-in language will need to be added to transaction documents in order to cater for the requirements applicable to banks regulated in the EU. In some transactions, parties decided to include bail-in language in the security documents. In addition, parties are more concerned with licensing requirements as EU-passporting will no longer work for UK domiciled lenders which causes certain roles (lender of record, agent/trustee) to be performed by continental entities.

The LIBOR transition has no particular bearing on German law governed lending transactions that would set them apart from those governed by other laws; parties would usually agree on a market standard replacement language.

COVID 19 has caused lenders and borrowers to discuss financial covenants in light of potential adjustment. This has certain effects on new transactions as parties seem to be more cautious when discussing and agreeing adjustment provisions (with a view to phrase those slightly more narrowly). COVID 19 requires parties to adjust certain transactions to the effects of the pandemic but the necessary changes to the existing documentation, namely covenant holidays pared with the introduction of liquidity covenants, is a trend addressing existing deals rather than setting a trend for documentation in general.

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