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Debt Finance 2024

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Germany: Trends & Developments

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Trends and Developments

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General Introduction

The German debt finance market continues to be under active and continuous development with key changes in the areas highlighted below:

- Sustainability has become an increasingly key factor in relation to the reporting obligations of more and more borrowers. The EU reinforced its relevance by adopting the Corporate Social Responsibility Directive and the Corporate Sustainability Reporting Directive and, most recently, by approving European Sustainability Reporting Standards, thereby harmonising standards for sustainability reporting obligations in the European Union.
- With the numbers of pre-insolvency financial restructuring and insolvency proceedings continuing to increase over the last few years, the German Act on the Stabilization and Restructuring Framework for Businesses (StaRUG) adopted in 2021 now offers a legal framework for pre-insolvency restructurings under German law with significantly enhanced structuring options. In 2024, a number of restructurings have been completed under this new StaRUG regime.
- Another current important development under German law focusses on distressed loans. The German Secondary Credit Market Act (KrZwMG) aims to reduce the number of non-performing loans and to prevent the accumulation of non-performing loans in the future, as well as to implement an elevated level of protection for borrowers.
- Also important are the new notification obligations of foreign companies to reduce the high susceptibility of the real estate market to money laundering.

New ESG-Reporting Standards

ESG-Reporting Standards that were introduced with the Non-Financial Reporting Directive (NFRD) have been significantly updated through the introduction of the Corporate Sustainability Reporting Directive (CSRD) (EU) 2022/2464.

Since 2017, certain companies had to report on their contribution to environmental, social and employee matters based on the NFRD. With the new CSRD, member states are now required to implement a comprehensive sustainability reporting regime into national law. While the NFRD provided some discretion with regard to environmental, social and governance factors and allowed the companies to disclose non-financial information based on local, international, branch or non-branch-specific standards, the CSRD introduces a comprehensive standardised sustainability reporting regime. In addition, the CRD requires companies to report not only on how sustainability issues affect their business but also on how their business impacts society and the environment (the so-called double materiality perspective). On 1 January 2024, the European Commission adopted the European Sustainability Reporting Standards (ESRS) that provide further detailed guidance on sustainability reporting under the CSRD and will ensure a harmonised application of suitability related disclosure requirements across Member States.

The disclosure requirements under the CSRD and ESRS for large companies falling within the scope of the NFRD and large non-EU companies listed were originally scheduled for application already in 2024, with the first reports due in 2025. However, the European Commission, Council and the European Parliament have postponed the application of the CSRD and the adoption of sector-specific requirements under ESRS as well as the standards for large non-EU companies by two years. This means these standards will now start applying from June 2026. Small and medium sized enterprises (SMEs) will have the

option to defer their reporting obligation by up to two years. Non-EU companies that exceed the specified turnover and subsidiary thresholds will have to start reporting in 2028, with the first reports due in 2029.

While the ESRS aims to harmonise sustainability reporting standards, the ESRS will apply in addition to other existing sustainability reporting, such as the standards issued by the Global Reporting Initiative (GRI). In Germany, many companies used the German Sustainability Code, which also incorporates the GRI, as a "point of reference". To ensure consistency and avoid double reporting, in September 2023, the European Financial Reporting Advisory Group (EFRAG) and the GRI published a joint statement on the high degree of interoperability between the ESRS and the GRI Standards. EFRAG and GRI have achieved significant alignment between their respective the definitions, concepts and impact disclosures. In addition, the ESRS may apply to companies that fall within another sustainability reporting regimes, such as the UK's reporting framework, with the Taskforce for Nature-related Financial Disclosures (TNFD) issuing final recommendations.

Despite common ground between the ESRS and other global sustainability reporting standards, the companies should take into account that the ESRS goes beyond previous disclosure frameworks. As a consequence, the ESRS will result in a notable increase of regulatory complexity and the administrative burden for companies.

On the other hand, the comprehensive definitions and notions under ESRS provide detailed helpful guidance and will help companies in their sustainability reporting under the CSRD.

StaRUG in Financing

Since 2021, StaRUG closed a long existing gap in German law regarding pre-insolvency restructurings. In particular, restructuring plans providing for substantial debt write-downs, debt equity swaps even against the resistance of certain creditor classes could only be implemented in the context of insolvency proceedings. StaRUG changed this by making a wide range of comparable restructuring measures available pre-insolvency. Recently, a number of German debtors have made use of the new restructuring-possibilities StaRUG offers and have completed their restructurings under this new regime.

Part-collectivity and intervention restrictions

StaRUG offers a wide range of additional tools and differs from the possibilities a post-insolvency restructuring provides, by, among other things, giving the distressed debtor the opportunity to select which of its obligations are to be included in a pre-insolvency restructuring. While the debtor can select which obligations will not be amended by a pre-insolvency restructuring plan, the StaRUG limits this optionality by excluding obligations owed to employees and from claims arising from tortious acts. While the German Act on Debt Securities provided a regulatory framework for the pre-insolvency restructuring solely of obligations owed under security such as bond notes, StaRUG allows a pre-insolvency financial restructuring over a variety of obligations, enabling a more comprehensive restructuring of a debtor's overall debt.

Recent restructuring that has been completed using StaRUG instruments have solidified the view in the market that these instruments are helpful to:

- materially restructure debtors' debt and equity financing allowing the continuation of their businesses; and
- provide for a clear and fair framework for stakeholders to maneuver within such restructuring, all without avoiding a business-harming insolvency and costly insolvency proceedings.

StaRUG in practice – Exit of the existing shareholders

Looking at the restructurings that so far have been completed under StaRUG, one widespread consequence was identified as the common exit of the existing shareholders. In these restructurings, the restructuring plan will typically reduce the share capital to zero, leading to a cancellation of the issued shares. Afterwards, a new capital increase with the exclusion of subscription rights effectively made (some or all) of the existing creditors the new equity owners of the debtor.

While some market participants see StaRUG instruments as an excellent way to avoid an insolvency, others point out the dangers of misuse: the existing shareholders can be "crammed-down" into the restructuring plan and left with no rights in the company. Whether the partially prescribed judicial approval of StaRUG's restructuring plan will prevent this potential misuse threat remains to be seen.

German Implementation Law for Distressed Loans

Introduction

In October 2023, the German government submitted a draft law to the German Bundestag on the promotion of orderly credit secondary markets and the implementation of a corresponding EU directive. The aim of this law is to reduce the number of non-performing loans and to prevent the accumulation of non-performing loans in the future, as well as to ensure a high level of protection for borrowers.

The law, the KrZwMG, came into force on 30 December 2023 and is based on the Directive (EU) 2021/2167 (Credit Servicers Directive, CSD). The new legal framework concerns transactions and services that relate directly to non-performing credit agreements.

Scope of application

The CSD defines the terms "credit servicer" and "credit purchaser" as the companies primarily involved in the trading of non-performing loans. According to Article 3(8) of the CSD, credit servicers are companies that carry out credit servicing activities. These companies manage and enforce the rights and obligations arising from non-performing loan agreements on behalf of a loan purchaser. The KrZwMG distinguishes between so-called credit servicing institutions and credit servicers.

Credit servicer institutions are entities that provide a credit service on behalf of the credit purchaser on a commercial basis or to an extent that requires a commercially organised business operation. The definition explicitly excludes CRR credit institutions, alternative investment fund managers (AIFM) and certain non-banks that carry out activities that generally qualify as credit services within the meaning of the CSD.

In addition to credit servicer institutions, the German legislator has introduced the term "credit service provider" in the Section 2 (4) KrZwMG, which includes both credit servicer institutions and CRR credit institutions as well as non-banks that are subject to certain requirements of the CSD.

Credit purchasers are persons or companies who are not credit institutions with a licence to provide credit business and who acquire a non-performing credit agreement or claims of the lender arising therefrom in the course of their commercial or professional activity, Section 2 (5) KrZwMG.

Credit services are (provided that a non-performing credit agreement or claims of the creditor arising therefrom have been acquired by a credit purchaser) the collection and enforcement of due payment claims and other claims of the creditor under the agreement, the renegotiation of rights, obligations or other material terms arising under the agreement, in accordance with the instructions of the credit purchaser, if the company providing the service is not a credit intermediary (within the meaning of Article 3(f) of Directive 2008/48/EC or Article 4(5) of Directive 2014/17/EU), handling complaints in connection with the agreement and informing the borrower of changes to interest rates, charges or payments due in connection with the agreement, Section 2 (3) KrZwMG.

Key regulatory requirements

Credit service providers and credit institutions that wish to buy and settle non-performing loans must obtain a licence before commencing their activities. This is intended to ensure the integrity and trustworthiness of market participants, while also protecting potential buyers. In particular, protecting potential buyers must enhance since the requirements that already apply to credit institutions, also apply to credit service providers. For example, the managing directors of such credit service providers must not only prove their expertise, but also prove that they have sufficient time to perform their duties properly.

The credit service providers or credit service institutions must act in good faith, fairly, and professionally. They must provide information to borrowers in a non-misleading and clear manner, and respect and protect the personal information and privacy of borrowers. Credit service providers or credit service institutions are also subject to organisational requirements and must ensure the competence and sufficient knowledge of their management board.

German legislation allows credit service providers to hold funds from borrowers for loan purchasers. These funds must be held in an escrow account at a credit institution. In addition, it obliges credit service providers to ensure that the escrow account is protected from the rights of third parties, and that the funds from borrowers are transferred to the escrow account for the borrower upon receipt.

Furthermore, the outsourcing of credit servicing activities by a credit service provider, or a credit institution purchasing NPLs, is regulated. Specifically, the outsourcing companies must ensure that the subcontractor complies with all obligations. The supervisory authorities may monitor compliance with the requirements along with the outsourcing company, regarding the specific services.

One of the key elements of the CSD is the introduction of the EU passport concept for credit service providers. This will enable companies to provide credit services across the EU. Credit service institutions that are authorised and supervised by the competent authority in another contracting state adhering to the national provisions implementing Directive (EU) 2021/2167 in that state, may provide the credit services covered by the authorisation in the home member state without a licence (European passport). If

BaFin, in its capacity as national authority of the host country, identifies violations, it is entitled to report these violations to the competent national authority of the host country. If the credit service provider does not take sufficient remedial action after BaFin has reported the violation to the national authority of the host country, BaFin is entitled to take supervisory measures directly against the credit service provider concerned. Furthermore, annual reports must be submitted to BaFin to ensure the ongoing compliance with the requirements of its supervision.

In addition, the law also provides for:

- notification obligations of the selling institution vis-à-vis the loan purchaser,
- reporting obligations to the BaFin and the Bundesbank, and
- information obligations of the loan buyer towards the borrower.

The law gives BaFin information and intervention rights. For example, credit service providers must submit their annual financial statements for the previous financial year so that BaFin can assess the economic situation and stability.

In conclusion, it is fair to say that this law regulates the secondary credit market significantly more than before. While this leads to greater security for the market and its participants, it should still be considered rational.

Transparency Register for Real Estate Transactions

Since 1 January 2023, the reporting obligations to the transparency register have been further expanded with the aim of ensuring transparency regarding the ownership of real estate. In order to achieve this goal, foreign companies with existing real estate are now also subject to the reporting obligation to the transparency register. This applies to any form of participation, including share deals. This reporting obligation does not apply only if it has already been fulfilled in another EU member state.

It can be assumed that the reporting obligations apply to all foreign companies that acquire shares in domestic companies, even indirectly. Even though not explicitly stated in the new provisions, this very likely also includes existing shares in companies holding real estate.

The new law regulates the inclusion of key real estate data in the transparency register. If there are any errors in the allocation, a large number of obliged persons (including banks and notaries) will be obliged to submit a corresponding discrepancy report from 1 January 2026. Now the originator of the discrepancy report will now not only receive the details of the identified beneficial owner, but also the associated documents. This means that voting trust agreements, fiduciary agreements, etc, which were previously only sent to the Transparency Register to check the registration, are now also sent directly to the obliged entity as the originator of the discrepancy report, with the restriction that these are only used for the KYC checks.

Violation of the reporting obligations lead to a risk of significant fines. These fines are based on the turnover of the company violating the reporting obligation. For a first violation, a fine of up to EUR150,000 can be imposed. In the case of repeated, systematic and serious violations, a fine of up to EUR1 million can be imposed.

Further, notaries are prohibited from notarising if a reporting obligation is violated. This can lead to property transfers being significantly delayed

or even failing due to these reporting obligations not having been complied with.

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