Commentary - Germany

In our publication “Legal Criteria for European Structured Finance Transactions” (the “EU Legal Criteria”), DBRS considers the application of the legal criteria and related methodologies for structured finance transactions in Europe. The criteria and methodologies set out in the EU Legal Criteria should be regarded as applying generally to a structured finance transaction in the Federal Republic of Germany (“Germany”). This commentary (“Commentary”) sets out certain specific considerations arising in the context of structured finance transactions documented under the laws of Germany (“German law”). Unless otherwise defined, words and expressions used in this Commentary shall have the meanings given to them in the EU Legal Criteria.

Regarding the legal framework, there is no specific German law governing structured finance transactions and structured finance transactions are therefore governed by different parts of German law. The German market is at the date of this Commentary dominated by collateralised debt obligations (CDOs), residential mortgage backed securities (RMBS) and ABS (of which Auto ABS prevail).

This Commentary is not exhaustive and does not address every legal issue that may arise in connection with a German structured transaction, nor does it purport to set out a full analysis of each of the legal principles that might be relevant, and is not be considered as legal advice.

Asset Transfer

SALE AND TRANSFER OF RECEIVABLES

Conflict of laws
In Germany the transfer of title in any asset requires the conclusion of two agreements; (i) the agreement on the obligation to execute the transfer of title (“Obligation Agreement”) and (ii) the actual execution (in rem) of the transfer of title (“Transfer Agreement”). For certain assets (e.g. real estate) further measures are required to perfect the transfer of title.

Up until 17 December 2009 Art. 27 et seq. of the German Conflicts of Law Act (Einführungsgesetz zum Bürgerlichen Gesetzbuch) provided that the parties to an Obligation Agreement were free to choose the applicable law for such agreement whereas any Transfer Agreement was required to be governed by the law governing the assets which were the subject matter of the Transfer Agreement. On 17 December 2009 the Rome I Regulation¹ became applicable in Germany. Art. 14 para 1 Rome I Regulation now provides that the actual transfer of title is governed by the same law that the parties have chosen for the Obligation Agreement. This is a material change of German law and simplifies the otherwise complex determination of applicable law. However, pursuant to Art. 14 para 2 Rome I Regulation a number of

legal aspects remain to be governed by the law governing the assets, in particular all aspects that serve to protect the rights of the debtor of the sold and transferred receivables (e.g. transfer restrictions, set-off rights).

**Transfer techniques**

Under German law receivables may be transferred by way of assignment or assumption of contract. In case of an assignment the Originator assigns its rights against a debtor whilst remaining party to the original contract. The assignment may take place without notifying the debtor. Assumption of contract requires consent by the debtor and leads to a complete replacement of the transferor as contractual party by the transferee.

**Restrictions on assignability**

In principle receivables may be freely assigned even if they are future receivables. But there are certain restrictions which may prevent a valid transfer:

- Non-existence; earlier assignment - a non-existing receivable cannot be assigned, and a receivable that previously has been assigned to a third party cannot be validly assigned again by the Originator.
- Contractual assignment prohibition - if debtor and creditor have contractually excluded the assignment of receivables an assignment is invalid unless both parties are businessmen and the creditor is not a bank. However, even if the assignment is valid the debtor may still pay to the Originator unless the debtor was notified of the assignment. This may be detrimental to the SPV when the Originator is unable or unwilling to pay to the SPV any sums received by the debtor.
- Restrictions on assignment could also result from the Originator’s obligation to comply with banking secrecy (Bankgeheimnis) obligations and to keep a debtor’s loan information confidential. The position has been subject to a number of conflicting decisions of the German courts and, following a judgment of the Federal Civil Court (Bundesgerichtshof) in 2007, the current position appears to be that the assignment of loan receivables is valid even if the assigning bank violates either banking secrecy rules or data protection rules in making the assignment. However, in such cases the debtor may have a claim for damages resulting from the violation of those rules. DBRS expects the transaction documentation to provide that data only be disclosed to the SPV in compliance with the guidelines of the German Federal Financial Supervisory Authority (“Bundesanstalt für Finanzdienstleistungsaufsicht” or “BaFin”), the German regulator, as laid down for asset-backed transactions in BaFin Circular 4/973.

---

2. The Frankfurt Court of Appeal ruled in a judgment of May 25, 2004 that the assignment of consumer loan receivables implies a violation of the banking secrecy and is void as it consequently contravenes a contractual prohibition of assignment implied in banking secrecy. On November 25, 2004 the District Court Koblenz and on December 17, 2004 the District Court Frankfurt opposed this view and ruled that German banking secrecy principles will not result in a contractual prohibition to transfer (consumer) loan receivables. The German Federal Civil Court (Bundesgerichtshof) has set forth in a judgment in February 2007 that the assignment of loan receivables is valid even if the assigning bank violates either banking secrecy rules or data protection rules in making the assignment. However, the Federal Civil Court did not rule out that the debtor may have a claim for damages resulting from the violation of the banking secrecy or the data protection rules. The German Federal Constitutional Court (Bundesverfassungsgericht) confirmed this judgment in a decree of July 2007 and held that in the case of transfer of loans the related transfer of debtor information does not contravene constitutional rights of the borrower.

3. The SPV will receive data only in encrypted form, the Originator will act as Servicer, the portfolio decryption key will be handed over to a Data Protection Trustee and the Data Protection Trustee will deliver the key only to a successor Servicer.
• The assignment of receivables which otherwise violates the law or would be harmful or contrary to public morality (contra bonos mores) is invalid (e.g. receivables of doctors against their patients which result from services subject to secrecy rules).

**Rights of debtors**

The debtor can invoke all rights against the SPV that he had against the Originator prior to the assignment and, if the debtor has not been notified of the assignment, the debtor will be entitled to validly discharge his payment obligation by making payment to the Originator.

If successfully raised, the exercise by a debtor of rights of set-off will lead to a reduction in the amount of the creditor’s receivable corresponding to the amount of the set-off claim, and therefore any set-off rights a debtor may have require particular analysis. Under German law any debtor is entitled to set off a claim against a creditor with a claim that the creditor has against the debtor provided his (the debtor’s) claim is due (fällig) and the creditor’s claim is dischargeable (erfüllbar) i.e. the debtor has the right to pay immediately as opposed to at some future point in time only. Although, generally, set-off under German law requires mutuality (i.e. that the claims exist between the same parties) the debtor may under certain circumstances declare the set-off also vis-à-vis the SPV. In particular, this would be the case if,

• such set-off rights were in existence and exercisable at the time of the assignment of the receivable (section 404 of the German Civil Code (Bürgerliches Gesetzbuch)(“BGB”)) or

• were acquired after such assignment by the debtor but without the debtor having knowledge of the assignment at the time of acquiring the right (section 406 of the BGB).

Such set-off rights may therefore have significant impact. The extent of the set-off risk in particular depends on the asset class. It is higher in asset classes where there are typically extensive relations between the Originator and the creditors (e.g. consumer loans) and lower in asset classes where the assigned claims are typically the only relationship between the Originator and the creditors (e.g. leasing receivables). DBRS analyses the risk on a transaction-by-transaction basis, relying on analysis from legal counsel where appropriate, and will seek representations from the Originator as to the extent of the risk in a particular transaction. DBRS expects the Originator to be in an informed position with respect to its ability to provide such representation. This representation may also be coupled with an indemnity to facilitate the recovery of a breach of representation. DBRS also considers any structural features that have been included in the transaction to mitigate the risk.

**TRANSFER OF SECURITY**

If a secured receivable is assigned by the Originator to the SPV German law differentiates between accessory and non-accessory security. Accessory security rights are dependent on the obligations to which they relate and cease to exist if the secured obligation ceases to exist. By contrast non-accessory rights are independent from the secured obligation. The main accessory security instruments that are relevant in the context of securitisation transactions in Germany are pledges and mortgages. Non-accessory security is granted in the form of security assignments or transfers and land charges. If the security is accessory it will be assigned by operation of law to the SPV. If the security is non-accessory it must be assigned independently to the SPV (or a third person), otherwise title to the security will remain with the Originator. Under the Rome I Regulation the parties may in principle freely choose the law applicable to such transfer but transfer of real estate related security rights must always take place in accordance with the law applicable in the country where the real estate is located.
Transfer of non-accessory land charges (Grundschulden), which are the common method of taking security over real estate in Germany, may be complex and cumbersome, and in the past different kinds of trust structures have been used for this purpose.

**Refinancing Register**

A method recently introduced to German law is the refinancing register (Refinanzierungsregister) which allows for a transfer of title without a modification of the land registry (Grundbuch). The registration of claims and securities with the refinancing register results in a separation claim (Aussonderung) with respect to the respective receivables and security (i.e. the SPV can ask for complete separation of the relevant assets from the insolvent estate of the Originator). It has to be noted however that, prior to the insolvency of the Originator, the mere registration in the refinancing register does not prevent the Originator from disposing of the claims and/or the land charges. Such actions, however, would result in a claim for damages against the Originator (although the value of such a claim may be limited in the context of an insolvency of the Originator). Furthermore, the registration in the refinancing register does not prevent other creditors from seizing those claims. Pursuant to Section 22j (1) sentence 3 of the German Banking Act under such circumstances the party registered in the refinancing register would have the right to exercise a third party action for enforcement (Drittwiderspruchsklage). However, uncertainties arise in relation to such third party action where the land charges secure not only the receivables sold to the SPV but also other receivables of the Originator vis-à-vis the debtors (e.g. claims and receivables arising from current account relationships or other loan agreements with the same debtors). DBRS reviews Eligibility Criteria to determine whether broad security purpose (weiter Sicherungswec) land charges have been included in the portfolio. DBRS expects the implications of such charges to be addressed in transaction legal opinions. The party registered in the refinancing register must perfect the transfer of the land charges/mortgages in the land register either upon the Originator's insolvency or some other trigger event in order to enforce its rights to the security. DBRS considers whether a reserve for the costs of registration has been implemented.

DBRS reviews any structural mitigants that may be present in a transaction which may include requirements under the transaction documents for the Originator to promptly perfect the transfer in the land register in the event that individual enforcement actions by third parties against the receivables and security are taken. DBRS also reviews the availability (or provision) of funds to effect such perfection if required. DBRS reviews transactions on a case by case basis to determine whether the risk is consistent with the ratings contemplated.

**TRUE SALE**

German law recognises the difference between a true sale and a non-true sale. The sale of a receivable is a “true sale” if it is without recourse to the Originator, and the Originator is only liable to the SPV if the receivable was not validly existing or fails to meet agreed eligibility criteria. In contrast, the sale is “non-true” if the SPV has a right to receive compensation from the Originator if the debtor does not pay. Although the principle is clear, a number of questions remain with respect to the precise criteria for the differentiation between true sale and non-true sale. The main criterion which is typically decisive in cases where questions arise, is whether and to what extent risks and rewards from the assigned claims remain with the Originator (e.g. due to purchase price adjustment clauses).
If a sale fails to meet the true sale criteria it may be re-characterised as a secured loan. While such a secured loan would not be invalid e.g. for lack of registration, such re-characterisation may have the following material consequences:

- If the Originator becomes insolvent the SPV is better protected in case of a true sale than a non-true sale. The SPV in case of a true sale has a separation claim (Aussonderung) with respect to the assigned receivables and security. Non-true sale allows only for segregation (Absonderung) which means that the SPV would be barred from enforcing the security over the receivables. Instead an insolvency receiver of the Originator would be authorised by German law to enforce the assigned receivables and the insolvency receiver would be entitled to deduct costs for the determination and realisation of the security which can be up to 9 per cent of the receivables plus VAT, if any.

- In certain circumstances where the sale does not constitute a true sale the SPV may get no title to the asset at all. For instance, where a (subsequently insolvent) Originator has assigned receivables for security purposes by way of a global security assignment and suppliers of the debtor deliver their goods to the debtor subject to extended title retention\(^4\), according to the Federal Civil Court (Bundesgerichtshof) the supplier takes preference over the rights of the SPV as assignee in case of a non-true sale but the SPV as assignee takes preference in case of a true sale.

- Non-true sale may mean that the Originator must still book the receivables on his balance sheet (and pay tax on them).

In order to ensure that the transfer of the assets from the Originator to the SPV constitutes a true sale, DBRS requests a true sale opinion from German counsel\(^5\).

---

4. Where the supplier keeps title to the goods until he receives full payment even though the debtor is entitled to on-sell the goods provided the receivables resulting from such on-sale are assigned for security purposes to the supplier.

5. In making its determination on the nature of the sale, counsel is expected to consider the direct credit enhancement provided by the Originator (e.g. subordinated loans, guarantees or comfort letters), the amount and variability of the purchase price, in particular adjustments depending on actual collections, the Originator’s obligations to repurchase or replace defaulted receivables, overcollateralisation, if, upon conclusion of the transaction, the surplus is returned to the Originator, the amount and variability of servicing fees, if the Originator is the servicer, and the retention of notes, in particular the first-loss piece, by the Originator. In conducting the true sale analysis, counsel is expected to review available case law which may include the law on factoring and forfaiting.
Special Purpose Vehicles

LEGAL STATUS
Germany does not have a securitisation law providing rules for the establishment of a SPV specifically designed for securitisations, and therefore where German SPVs are used in securitisations they are established on the basis of the general provisions of German law. German SPVs are mainly used under the TSI Securitisation Platform, established by True Sale International GmbH, an initiative of 13 banks in Germany aimed at promoting the German securitisation market. More than 70 Transactions have so far used the platform for securitisation.

The two forms commonly used for German SPVs are the private limited company (Gesellschaft mit beschränkter Haftung – “GmbH”) and the entrepreneurial company with limited liability (Unternehmergesellschaft (haftungsbeschränkt) – “UG (haftungsbeschränkt)”). Under both forms the SPV constitutes an independent legal entity. The form of the UG (haftungsbeschränkt) has been established by a recent change of the law and does not differ from the GmbH regarding liability, but the UG (haftungsbeschränkt) can be established with a lower share capital. Both limited company forms can establish their business seat by their articles of association and may choose a foreign administrative seat. As the Originator should not have any control over the SPV or be a shareholder of the SPV the shares of such GmbH or UG (haftungsbeschränkt) are held by three charitable foundations (Stiftungen) committed to the promotion of German corporate finance and capital markets. Such orphan structures avoid the possibility of the SPV being consolidated with the Originator.

German SPVs are often managed by a corporate services provider who will manage the affairs and provide directors to the SPV.

BANKRUPTCY REMOTENESS
Bankruptcy remoteness is required to ensure the structural benefits of the transaction, and DBRS checks whether the criteria for bankruptcy remoteness described in the EU Legal Criteria are met. In addition to those general criteria, the following specific issues may arise in relation to a German transaction:

Limiting Activities

Limited powers
A limitation of powers of the SPV can be achieved by limiting the objects of the SPV in its articles of association to the acquiring and holding of the receivables and the issuing of notes. Alternatively such covenant can be made in a contract with the noteholders or their representative. With limited exceptions German law does not have an ultra vires doctrine which would invalidate actions outside the scope of powers granted in the SPV’s constitutional documents. Therefore, in general, the SPV might, despite a limitation of its powers, conclude binding actions beyond its limited powers.

6. Since the beginning of 2011 a legal definition of “special purpose vehicle” has been added to the General Banking Act (Kreditwesengesetz), but these changes are not concerned with the establishment of an SPV.
7. Most SPVs used in German securitisations are incorporated outside Germany, in jurisdictions such as Jersey, Luxembourg, the Netherlands and Ireland because such jurisdictions provide more favourable legal and tax treatment. With regard to the taxation of non-German SPVs please see the section on ‘Tax’ below.
**Limited recourse and non-petition**

It is essential that all transaction documents the SPV concludes with other parties contain clauses that restrict the possibility of the SPV entering bankruptcy. Non-petition clauses restrict a creditor to the SPV from filing bankruptcy proceedings and limited recourse provisions restrict claims to the monies available to satisfy those claims. Under German law, a party is generally free to waive its claim against another party in advance. However, claims which arise out of wilful misconduct, gross negligence or other negligent breaches of certain material obligations cannot be excluded in advance. In addition, a general prohibition of a party to sue the SPV might be held to contraven bonus mores (sittenwidrig). Only very few rulings of German courts on these issues exist. With regard to bonus mores, in two cases a clause prohibiting the parties from bringing legal procedures in court was held valid. The first case concerned a lease agreement for an apartment; the ‘non-petition’ provision was upheld notwithstanding that German courts are typically particularly anxious to protect tenants against the superior bargaining power of landlords. In the second case, a similar provision was upheld notwithstanding that the court stressed the fact that it was the economically weaker party which the “non petition clause” purported to preclude from bringing a legal action against the other party. However, the court also pointed out that particular circumstances might warrant a different result. In a third case the court held that as a principle, a contractual agreement on the prohibition of suing the other party is valid. Because the parties to an agreement may validly waive their rights under the agreement they are also entitled to refrain from court proceedings, which is regarded by the courts as less than a complete waiver. As limited recourse and non-petition clauses are essential in securitisation transactions to ensure that all participants receive the benefits to which they are contractually entitled, DBRS requests confirmation of the effectiveness of the limited recourse and non-petition in the legal opinions provided for the transaction.

**Identity independent from that of an Originator - Consolidation risk**

The SPV must be an independent entity from the Originator. This is necessary in order to avoid the assets of the SPV being considered part of the insolvency estate of the Originator or shareholder of the SPV. German law would “pierce the corporate veil” in cases where assets are commingled, a material undercapitalisation exists or where controlling shareholders put the existence of the company at risk. DBRS may request a German legal opinion to provide comfort regarding the non-consolidation of the SPV and its German parents. In case the insolvency or corporate law of other jurisdictions were to apply, equivalent legal opinions provided by counsel in those other jurisdictions may also be requested.

---

**Security and Bond Documentation**

**FIDUCIARY ARRANGEMENT**

In a true sale securitisation transaction, typically a fiduciary or agency agreement (Sicherheitentreuhandvereinbarung) governed by German law will be entered into. In light of the function and objective of this fiduciary agreement it is often referred to as a trust agreement even though, from a strictly legal

---

8. Sections 138, 276 para 2 or 307 para 1 German Civil Code (Bürgerliches Gesetzbuch)
9. Decisions by the District Court (Landgericht) of Bonn dated 15 April 1965 (NJW 1965, 2202) and the Upper District Court (Oberlandesgericht) of Celle dated 5 April 1968) (OLGZ 1969, 1).
10. Decision by the Upper District Court (Oberlandesgericht) of Hamm dated 11 October 1996 (OLGR 1997, 1).
perspective, German law is incompatible with Anglo-Saxon style trust agreements but, rather, requalifies them as fiduciary or agency agreements. For ease of terminology, the term “trust agreement” will also be used in this Commentary.

The objective of the trust agreement is to protect holders of notes of the SPV and certain other creditors. The main parties are the SPV and the security trustee but, typically, others are added as parties such as the lead managers and arrangers, any subordinated lenders, the data protection trustee, swap counterparty, paying agent, interest determination agent, calculation agent, account bank and corporate services provider. This ensures that the enforcement of the security can be performed by the security trustee and will be binding upon all involved parties. For this reason, the security trustee is typically entitled to effect the relevant cash payments on behalf of the SPV. The holders of notes are not party to the trust agreement but, rather, the trust agreement is entered into for their benefit creating third party rights (echter Vertrag zugunsten Dritter).

With regard to the security, the security trustee is legally a secured party (Sicherungsnehmer) in relation to the SPV (i.e. it legally owns the security but for the benefit (i) of the SPV and (ii) of the various transaction creditors). In the event of insolvency of the security trustee, however, its security rights would be subject to segregation (Aussonderung) as assets of the SPV.

**TYPE OF SECURITY**

Under German law, the granting of security rights is only valid, and such security rights can only persist, in the presence of a reason for that security. Therefore, the SPV typically grants a specifically-created right to the security trustee to request collateral.

With regard to assets including receivables, German law provides for two types of security, a charge (Pfandrecht) or an assignment by way of security (Sicherungsübereignung or Sicherungsabtretung). A charge is only valid if the asset is physically transferred to the chargee or in the event of a receivable the third-party debtor is notified of the charge of the receivable. There is no such requirement of a transfer or notification for an assignment by way of security.

German law does not provide for the concept of a floating charge. Nevertheless, contingent assets and receivables due in the future may be used as collateral if they are sufficiently specified. Insolvency rules, however, might limit the effect of a pledge or assignment by way of security in respect of future assets (See further “Insolvency Issues – Future Cash Flows” below).

In general, the security package for German securitisations is comprised of a security interest over specific assets of the SPV such as the receivables, various transaction accounts and the rights the SPV may have under various transaction documents, including claims in the event of breach of representations or warranties, insurance claims, unilateral rights (Gestaltungsrechte) (in particular termination rights), rights under currency and interest swaps, security rights like retention of title\(^\text{12}\) (Vorbehaltseigentum) or ownership transferred for security purposes\(^\text{13}\) (Sicherungseigentum).

---

11. To avoid non-compliance with data protection rules potentially resulting in the invalidity of the granting of security, a data trustee is typically appointed with regard to the transfer of receivables. See above ‘Asset Transfer’ – ‘Restrictions on the Assignability’.
12. Such as where a seller grants a respite for payment of the purchase price and, as security, retains ownership. Such retention of title results in a separation claim (Aussonderungsrecht), cf. “Transfer of Security” above.
13. Ownership transferred for security purposes is relevant where a lender is granted legal ownership in certain assets of the debtor as security. This allows only for segregation (Absonderung) cf. “True Sale” above.
Some special rules for security arrangements exist in Germany. As mentioned above, the refinance register (Refinanzierungsregister) permits credit institutions to transfer encumbrances to others without a modification of the land registry (Grundbuch). Specific legislation, the German Covered Bond Act (Pfandbriefgesetz) exists for covered bonds (Pfandbriefe) and there are special regimes for the reorganisation of financial institutions (see further under ‘Insolvency’ below). Non-compliance with specific data protection rules in Germany can also potentially result in the transfer of claims and, thus, of the respective security being regarded invalid. As a result DBRS expects to see a data trustee being appointed with regard to the transfer of receivables.

DBRS acknowledges that the security package has to be tailored to the specifics of a transaction. DBRS expects the transaction legal opinion to confirm that the granting of security under the security documents is effective and binding and is not capable of being set aside on the insolvency of the SPV.

Insolvency Issues

The German legal opinion for a German structured finance transaction will have to consider a number of German insolvency issues. The most material issues are the following:

APPLICABILITY OF GERMAN INSOLVENCY LAW

Whether or not German insolvency law applies depends on the conflict of law rules. The German conflict of law rules relating to the applicable insolvency law differentiate between (i) parties located in EU and non-EU member states and (ii) parties that are finance companies and non-finance companies. The EU Insolvency Regulation\(^\text{14}\) applies to finance companies located in EU member states (except Denmark), whereas sec. 335 to 358 of the German Insolvency Code (“GIC”) apply in all other cases.

ENFORCEMENT

In the event of a re-characterisation of a true sale as a secured loan and if in addition the administrator of the Originator is regarded as the economic owner of the receivables or has possession of the assigned security, the SPV may be barred from enforcing the security. Instead the administrator of the Originator of the receivables which have been assigned for security purposes is authorised by German law to enforce the assigned receivables (on behalf of the SPV). The administrator is obliged to transfer the proceeds from such enforcement to the SPV. He may, however, deduct his fees from such proceeds; such fees may amount to up to nine (9) per cent of the enforcement proceeds plus applicable value added tax.

In the event of a risk that a German credit or financial services institution may not be able to settle its obligations vis-à-vis creditors, under sec. 46 of the Banking Act (Kreditwesengesetz – “KWG”), the BaFin is entitled to suspend the enforcement of any security provided by the insolvent institution with a view to facilitating its rehabilitation or orderly disposal. It is currently uncertain whether the due date of the institution’s payment obligations can be postponed. Where the economic problems of an institution are likely to incur difficulties for the national economy, under sec. 47 of the Banking Act, the Federal Government may impose a moratorium including but not limited to a deferral of the due date of all

---

payment obligations of the relevant institution. Because under German law a secured obligation must be due and payable as a prerequisite to the commencement of enforcement proceedings, as a consequence, the security interest might not be exercisable. However, BaFin has no power to remove secured assets or void otherwise valid security arrangements, and any interest accruing on those securities would continue to belong to the SPV. In addition, unless the due date is postponed, a secured creditor is not prevented from enforcing the security where possession of the security has been transferred to the secured creditor or in cases where the restriction on enforcement would not result in a liquidity benefit to the relevant institution. DBRS reviews the circumstances applicable to each particular transaction and may request analysis to be carried out by German counsel on this issue.

**CLAWBACK RISK / VOIDABLE TRANSACTIONS**
Sections 129 through 134 GIC establish the circumstances under which transactions are voidable. The most important scenarios are the following:

*Mismatching payments and transfers*
The administrator can void transactions made during the three month period prior to the filing for insolvency if such transactions gave to a creditor security or satisfaction to which such creditor had no right (sec. 131 GIC). A right to security or satisfaction can arise from a contractual agreement entered into before the insolvency or from law. Furthermore, a right to security can be created even during the insolvency proceeding, if the secured receivable is newly created (e.g. by giving a loan).

*Matching payments and transfers*
The administrator can void transactions which gave to a creditor security even if such creditor was entitled to such security provided that (i) if security was provided during a three-month period preceding the request to open insolvency proceedings, if the debtor was unable to pay its debts as they fall due on the date of the transaction, and if the creditor was aware of such cash flow insolvency of the debtor on this date, or (ii) if security was provided after the request to open insolvency proceedings, and if the creditor was aware of the debtor’s cash flow insolvency on the date of the transaction, or of the request to open insolvency proceedings (sec. 130 GIC).

*Intent to harm Creditors*
The administrator can void transactions by the Originator if such transactions were entered into by the Originator in the last ten years prior to the filing for insolvency with the intent to harm his creditors provided the other party knew of such intent (sec. 133 para 1 GIC).

DBRS expects transaction documentation to address the risks, including representations from the Originator as to its solvency and for the implications of the above provisions to be addressed in transaction legal opinions.

**FUTURE CASH FLOWS**
German insolvency law provides as a rule that an insolvency receiver may decide whether contracts under which both parties have assumed obligations vis-à-vis each other which neither party has yet fully honored, are to be fulfilled or not. If the receiver opts for fulfillment both parties must do so, if he opts against fulfillment the non-insolvent party may file a damage claim for non-fulfillment which will be treated as normal insolvency claim.

For the sale of receivables on a revolving basis and/or the sale of future receivables in general this means that there is a risk that such receivables will not be transferred to the transferee if the transferor is insolvent before the receivables come into existence.
DBRS analyses the risks in relation to future cash flows in German transactions on a case-by-case basis.

Servicing and Collections

Servicing and collection of the assets is normally carried out by the Originator in German transactions. The potential commingling risk should be analysed in accordance with the general law.

According to the KWG the Federal Financial Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht) may forbid a credit institution from receiving payments under certain circumstances which may occur well before the beginning of formal insolvency proceedings. DBRS expects the servicer termination events to explicitly include this case.

Under the general rules of German insolvency law, any collections received by the Originator and not yet transferred to the SPV before the opening of insolvency proceeding will be trapped in its insolvent estate, due to the fungible nature of money. The SPV will be an ordinary unsecured creditor in respect of such amounts. In order to mitigate such risk, the SPV must ensure that all amounts collected by the Originator are swept and transferred to its own account as frequently as practically possible. DBRS may determine that a funded reserve account to cover periods of payment disruption and/or credit losses caused by the Originator’s insolvency would be consistent with the contemplated rating.

Similarly, commingling risk must be considered in connection with any account bank. In the event of an insolvency of the account bank the SPV would be a general unsecured creditor of the bank. The EU Legal Criteria – Transaction Parties – Servicing and Collection – Collection Accounts and Commingling describes features that can be included in a transaction to mitigate this risk.

Tax

SPV LEVEL - TAX NEUTRALITY OF THE SPV

Domestic seat
As mentioned above, if a securitisation transaction involves a German SPV the legal entities of a limited liability company (Gesellschaft mit beschränkter Haftung) or a special purpose company incorporated with limited liability (Unternehmergesellschaft (haftungsbeschränkt)) are typically used as a special purpose vehicle. An SPV that maintains a seat and/or place of management in Germany will generally be subject to unlimited tax liability in Germany and will generally be subject to German corporate

15. If a claim of the Originator from a consumer loan is assigned to the SPV, the borrower must be notified of this and must be provided with certain information, unless the Originator has agreed with the SPV that only the Originator may act as servicer sec. 496 para 2 German Civil Code.
income tax, solidarity surcharge and trade tax on its worldwide income. The aggregate rate for corporate income tax and solidarity surcharge is approximately 15.8 per cent, whereas the trade tax is determined and levied by the local municipality based on a multiplying factor which, on average, leads to a trade tax of 14 per cent.

Usually the aggregate amount of the income received by the SPV does not substantially exceed the aggregate amount of the business expenses incurred by the SPV in a taxable period, so that the SPV's corporate tax base should be low and, thus, its corporate tax liability should also be low. Although the SPV, if structured properly, generates only minor profits, it should be observed that due to the debt financing of the SPV, the debt financing costs can be subject to the limitation of the interest stripping rules (Zinsschranke) pursuant to sec. 4h German Income Tax Act (Einkommensteuergesetz - “EStG”). Pursuant to those rules net interest expenses (i.e. interest expenses exceeding the interest income, exceeding 30 per cent of the SPV's earnings as determined for German tax purposes, are not deductible). The interest stripping rules only apply if the net interest expenses equal or exceed EUR 3,000,000 in the relevant business year. It should be expected, however, that the SPV's interest received should at any time equal or even be higher than the interest paid on the notes (or other instruments). As a consequence, the net balance of interest payments should be negative (or, at least, be below EUR 3,000,000). If unexpectedly the net interest payments equaled or exceeded the EUR 3,000,000 threshold in a business year, the interest stripping rules would not apply if the SPV qualifies as a non-consolidated entity (i.e. if the SPV is or may not be included into the consolidated statements of a group according to the applicable accounting standards). The German Federal Ministry of Finance (Bundesfinanzministerium) has stated that SPVs in securitisation transactions are regarded as non-consolidated entities for purposes of the interest stripping rules if the entity is only consolidated because of economic considerations taking into account the allocation of benefits and risks. Although, under a new consolidation rule within the German GAAP amended by the Accounting Modernisation Act (Bilanzrechtsmodernisierungsgesetz) stipulated in sec. 290 para 2 no. 4 of the German Commercial Code (Handelsgesetzbuch) SPVs used in securitisation transactions might be consolidated, that rule is based on economic considerations taking into account the allocation of benefits and risks. Therefore, the exemption stated by the Federal Ministry of Finance in the decree should still apply, so that the interest stripping rules should not kick in. If, against such expectation, the interest expenses of the SPV equaled or exceeded the threshold of EUR 3,000,000 and the exemption for non-consolidated entities did not apply, non-deductible interest expenses could be carried forward and set-off in subsequent business years, subject to the aforementioned limitations pursuant to sec. 4h EStG.

Prior to the establishment of a German SPV, a tax ruling (verbindliche Auskunft) may be obtained from the German tax authorities on the tax treatment of the SPV. Such ruling may confirm the deductibility of interest payments made by the SPV.

DBRS requests an opinion confirming the tax neutrality of the SPV.

Foreign seat
If the SPV has a foreign seat and/or effective place of management, it is subject to foreign taxation in the state of residence and/or place of management.

It may, however, incur a tax liability in Germany if the effective place of management is established in Germany. The effective place of management, from a German tax perspective, is located where the decisions of major importance of the SPV are taken. As long as the decision-making process remains

with the representatives of the SPV outside of Germany, the place of management should not be located in Germany. This should be the case if the purchase and transfer of receivables, the negotiations of the conditions of the purchase and the issuance of the notes takes place abroad, even if the servicing is fulfilled in Germany.

In addition, if the Originator undertakes to administer, collect and cash the receivables under previously agreed terms, so that it is not bound by the SPV’s instructions the Originator does not qualify as a permanent agent (ständiger Vertreter) for the SPV according to sec. 13 German General Tax Code (Abgabenordnung), and as a result the SPV will not become subject to limited tax liability in Germany according to sec. 49 para 1 no. 5 EStG. Consequently, if structured adequately, the risk of a tax liability of the foreign SPV in Germany can be mitigated.

In light of the above, DBRS expects an opinion that confirms the tax neutrality of the SPV in Germany even where the SPV may be established outside Germany.

**SPV LEVEL - WITHHOLDING TAX**

If structured properly, German withholding tax (Kapitalertragsteuer) should not arise on interest payments received by the Originator (in its capacity as servicer) or the SPV. From a tax perspective, the Originator should not derive capital income from collected receivables forwarded to the SPV. The SPV should not be obliged to withhold taxes on interest payments if it has been granted an exemption certificate (Dauerüberzahlerbescheinigung) issued by the local tax authority stating that the SPV’s expected corporate income tax falls short of the amount of tax to be withheld.

The SPV should not be obliged to withhold taxes on interest payments pursuant to sec. 20 para 1 no. 7 EStG, if the SPV is - as expected - neither a domestic credit institution (inländisches Kreditinstitut), a domestic financial services institution (inländisches Finanzdienstleistungsunternehmen), a domestic securities trading company (Wertpapierhandelsunternehmen) nor a domestic securities trading bank (Wertpapierhandelsbank) within the meaning of the KWG.

DBRS requests an opinion confirming that no withholding tax is required to be withheld on interest payments at the SPV level.

**SPV LEVEL - TRADE TAX**

An SPV with a domestic seat fulfils the criteria of a business enterprise (Gewerbebetrieb) because of its activity as a corporation, and as a result will generally be subject to German trade tax. In principle, the corporate income tax base also constitutes the tax base for German trade tax purposes. However, 25 per cent of the interest payable and deductible by the SPV will be added-back to the SPV’s tax base.

The increase of the SPV’s trade tax base does not, however, apply if the SPV falls under the exception provided for by sec. 19 para 3 no. 2 German Trade Tax Application Directive (Gewerbesteuerdurchführungsverordnung - GewStDV). The exception applies to scenarios where businesses exclusively acquire credit receivables or assume credit risks pertaining to loans originated by credit institutions and refinance, in the case of the acquisition of the receivables, and in the case of the provision of a security in respect of the assumed credit risks, by issuing debt instruments. In a typical true sale, these conditions should be satisfied. If no loan receivables are securitised, the trade tax add-back may be avoided by establishing a tax group between the SPV and a credit institution within the meaning of sec. 1 KWG. A tax group, however, may result in disadvantages related to the interest stripping rule.
A foreign SPV should not be subject to German trade tax, unless it establishes a permanent establishment in Germany.

DBRS expects an opinion confirming that the SPV fulfils the conditions under the tax-privilege set forth by sec. 19 para 3 no. 2 German Trade Tax Application Directive.

**SPV LEVEL - VALUE ADDED TAX**

The sale and transfer of the receivables as well as their collection can be considered as value added tax (“VAT”) services rendered by the Originator for the benefit of the SPV. The SPV, in a typical true sale, may render a service to the Originator by assuming the default risk on the one hand and, on the other hand, another service to the investor by issuing the securities.

**Tax status of the Originator**

The sale and transfer of a claim in a securitisation transaction generally fulfils the criteria of a taxable other service (sonstige Leistung) according to sec. 1 para 1 no. 1 German Value Added Tax Act (Umsatzsteuergesetz - “UStG”) in conjunction with sec. 3 para 9 sentence 1 UStG. As a transaction related to cash receivables it is, however, tax-exempt according to sec. 4 no. 8c UStG.

If the receivables are sold to a foreign SPV, the services of the Originator should not be taxable in Germany pursuant to sec. 3a para 2 UStG.

The retained servicing by the Originator in a true sale transaction is regarded as an ancillary and, thus, either tax-exempt or non-taxable (non-German SPV) service. As a consequence, it can be assumed that no VAT accrues, if it is the Originator and not the SPV that acts as servicer.

**Tax status of the SPV**

If the German SPV services the receivables, it would be deemed to render factoring services to the Originator subject to VAT. In a typical true sale, however, the SPV should not provide such servicing. Instead, the sale of receivables should be considered as non-taxable from the perspective of the SPV. As regards to the issuing of notes, such activity should either be tax-exempt (sec. 4 no. 8c UStG) or, related to foreign entrepreneurs or investors in non-EU member states, and non-taxable. Under these circumstances, a German SPV should neither charge VAT upon issuing the notes nor deduct any input VAT.

An SPV may become secondarily liable for VAT owed and not paid by the Originator in respect of the purchased receivables pursuant to sec. 13c UStG. However, it can be expected that the Originator of the purchased receivables has not opted or could not opt for a taxable treatment of its financing services rendered to the debtors. Therefore, no VAT liability and, consequently, no secondary liability should arise for the SPV.

The VAT status of a foreign SPV is subject to the national law of the state of residence. If located within the EU, the VAT treatment should correspond to the German principles as a result of the EU harmonisation in respect of VAT.

As with other potential tax liabilities, DBRS expects tax counsel to opine whether and to what extent German VAT may arise in respect of any of the payments made to or from German counterparties.

---

ASSET LEVEL - FOREIGN INVESTORS
Non-German resident note holders should generally not become subject to limited tax liability in Germany on interest payments received under the notes. Exceptions apply in scenarios where (i) the notes form part of the business property of a permanent establishment or representative or (ii) the interest income otherwise constitutes German source income (such as income from the letting of German-situs property).

Non-residents are generally exempt from German withholding tax provided that the notes are not held in a custodial account maintained with a German branch of a German or non-German credit institution or financial services institution, a securities trading company or a German securities trading bank.

Withholding tax, if applied, may be (partially) refunded based upon the applicable double tax treaties concluded by the relevant foreign state of residence and Germany.

ASSET LEVEL - STAMP DUTY / CAPITAL TAX
Germany does not levy stamp duties, capital tax or registration tax.

Other Specific Local Issues

CONSUMER LOANS
Specific issues may arise in connection with certain receivables as a result of consumer protection provisions incorporated in the BGB. In case of consumer loans18, DBRS expects the Originator to be in a position of knowledge sufficient to enable it to make a representation to the SPV in the transaction documents covering the compliance of such consumer loan agreements with all applicable consumer protection legislation, and may request an analysis in the transaction legal opinion.

Right of revocation
A borrower which qualifies as consumer is entitled to a right of revocation (Widerrufsrecht) for a period of two weeks which begins at the point of time when the consumer has been informed in text format (i.e. for example in written form, by email or pdf document) by a clearly drafted instruction which provides certain information on the right of revocation, sec. 355 BGB. If the consumer is not properly notified of this right of revocation and has not been provided with the required information, the consumer may revoke its consent at any time during the term of the consumer loan. German courts have adopted strict standards to such notification requirements to commence the two-week revocation period. As a consequence of a revocation the borrower would be obliged to repay the consumer loan. The repayment amount the borrower is obliged to repay amounts to the received loan amount plus interest thereon for the period of actual lending19.

18. The term “consumer” is defined in sec. 13 BGB as a natural person who enters into a legal transaction for a purpose that is outside his trade, business or profession. Loans which qualify as consumer loans will be subject to sec. 491 et seq. BGB.
19. Such interest rate might not exceed 0.5 to 1 per cent (in case of a time period not exceeding one year the rate is 1 per cent and otherwise 0.5 per cent).
DBRS typically expects the portfolio to contain only receivables from consumer loans for which the two-week period has expired.

**Prepayments**
A borrower which qualifies as consumer is entitled to prepay a consumer loan at any time.\(^{20}\)

**Obligation to inform borrower of assignment**
If a claim of the Originator from a consumer loan is assigned to the SPV, the borrower must be notified of this and be provided with certain information unless the Originator has agreed with the SPV that only the Originator acts as servicer (i.e. no person other than the Originator may contact the borrower in connection with payments under the loan). Such obligation is set out in sec. 496 para 2 BGB.

**Linked contracts**
A contract for the supply of goods (e.g. a purchase contract) or for the provision of services on the one hand, and a consumer loan contract on the other hand, may be considered linked contracts (verbundene Verträge) pursuant to sec. 358 para. 3 BGB, if the loan fully or partially serves to finance the other contract and both contracts constitute an economic unit. This will be determined from a consumer perspective and is the case if, for example, the supplier of the goods and the lender cooperate with each other and the lender finances the consideration payable by the consumer for the goods. In general, issues regarding consumer loans most commonly arise under Auto ABS securitisations. Under these securitisations the loan contracts of the originator and the various vehicle sale contracts will be treated as linked contracts. As a consequence, if the borrower has a defence (Einwendung) against the supplier of such goods or services which may for example derive from a purchase contract under which defective goods have been delivered or from a contract for the provision of services under which poor services have been provided, such defence may also be raised against the SPV’s claim for payment under the linked consumer loan, sec. 359 BGB. In case the linked contract for the supply of goods or services is deemed to be invalid or has been rescinded, the borrower may refuse further payments under the consumer loan and request repayment of the instalments and other amounts already paid under the consumer loan contract. Such right can be exercised by the borrower against the transferee.

\(^{20}\) Section 500 para.2 of the German Civil Code.