A LOAN MARKET ASSOCIATION PUBLICATION

Schuldscheindarlehen – LMA Product Guide (Updated Version 2016)

Loan Market Association
10 Upper Bank Street, London E14 5JJ

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10 Upper Bank Street, London E14 5JJ

Telephone: +44 (0)20 7006 6007
Fax: +44 (0)20 7006 3423
Email: lma@lma.eu.com
Website: www.lma.eu.com

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The Loan Market Association

The Loan Market Association (LMA) is the trade body for the EMEA syndicated loan market and was founded in December 1996 by banks operating in that market. Its aim is to encourage liquidity in both the primary and secondary loan markets by promoting efficiency and transparency, as well as by developing standards of documentation and codes of market practice, which are widely used and adopted. Membership of the LMA currently stands at over 600 and consists of banks, non-bank lenders, law firms, rating agencies and service providers. The LMA has gained substantial recognition in the market and has expanded its activities to include all aspects of the primary and secondary syndicated loan markets. It sees its overall mission as acting as the authoritative voice of the EMEA loan market vis à vis lenders, borrowers, regulators and other interested parties.
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INTRODUCTION

What are Schuldscheindarlehen and how do they work? This Product Guide seeks to address these questions and more. It is aimed at persons less familiar with the product, in particular the international borrower and lender/investor. The Guide gives current market perspectives, outlines the legal framework and summarises legal nuances particular to the product.

The term Schuldscheindarlehen (in the singular) is perhaps best translated as "a loan evidenced by a certificate of indebtedness". The product has been in existence for many years with predecessors dating back several centuries. In recent years, there has been a marked increase in overall volumes and increased interest in the product, both from a domestic German and an international perspective. In late 2012, the LMA decided to investigate where and to what extent it could add value in the Schuldschein market, specifically with increasing internationalisation in mind. A Working Group was formed, based in Germany, with broad representation from both a commercial and legal perspective, bringing with it many-sided proprietary experience of structuring the product. This Guide is the result of extensive collaborative work by all involved in this Group.

The overview provided below sets out the key aspects of Schuldscheindarlehen and may be regarded as an introduction to the product. This Guide does not claim to be an exhaustive source of information in this regard. Parties should seek legal advice prior to entering into any Schuldscheindarlehen agreement and should also consult the loan arrangers.

Acknowledgements

The LMA would like to thank the following for their contributions in the production as well as the latest update of this Guide in 2016:


(The following text has been translated from the German original for information purposes).
1. FRAMEWORK CONDITIONS

1.1 Legal nature

The term **Schuldscheindarlehen** is not legally defined. It is a financial instrument with distinct legal characteristics. Under German law, **Schuldscheindarlehen** refers to an underlying loan agreement for which a separate borrower's note (**Schuldschein**) stating the loan receivable is usually, but not necessarily, issued. The borrower's note does not constitute a security within the meaning of German civil and commercial law or within the meaning of the German Securities Trading Act (**Wertpapierhandelsgesetz**, "WpHG") or the Securities Prospectus Act (**Wertpapierprospektgesetz**, "WpPG") and generally only serves as documentary evidence of a debt. This means that **Schuldscheindarlehen** are exempted from the obligation to publish a prospectus under European prospectus law. It is not possible to use a clearing system for such loans and they may not be listed or traded on any stock exchange.

1.2 Parties

The parties normally comprise the borrower, the guarantor (if any), the investor(s) (acting as lender(s)) and one or more banks acting as arrangers, sometimes also assuming the role of primary lender (cf. 1.6). In addition, the documentation usually provides for the existence of a paying agent or calculation agent who acts on behalf of the borrower. If, in exceptional cases, a **Schuldscheindarlehen** is secured, a designated party acting as security trustee is generally required.

1.3 Differences between **Schuldscheindarlehen** and syndicated loans / debt securities and other private placement products

**Schuldscheindarlehen** are bilateral loans and have a hybrid structure which sits between debt securities and bilateral/syndicated bank loans. They enable borrowers to gain access to institutional capital markets investors that usually cannot be reached via other bank financings. Borrowers can offer investors longer maturities and lower investment levels than would be usual in the syndicated loan market.

**Schuldscheindarlehen** granted by two or more lenders differ from syndicated loans above all in that there is generally no provision for collective decision taking by the lenders and settlement between the lenders. Coupled with the fact that **Schuldscheindarlehen** are usually freely transferable in whole or in part, the former results in the process for any amendments and waivers being more burdensome,
given that the consent of each individual lender must be sought in respect of its part of the Schuldscheindarlehen (NB no all-lender consent in respect of the aggregate amount of the Schuldscheindarlehen).

Compared to the traditional method of issuing bearer bonds (Inhaberschuldverschreibung) to raise debt capital via capital markets, Schuldscheindarlehen, being bilateral loan agreements, enable the borrowing company to directly negotiate with each investor on any matter with regard to the Schuldscheindarlehen. Unlike bearer bonds, Schuldscheindarlehen held by lenders in accordance with International Financial Reporting Standards (IFRS) are not evaluated according to the "mark-to-market" principle. The issuance of bearer bonds will generally afford higher issuance volumes, a broader investor base and a more developed secondary market, however this does bring with it the requirement for more comprehensive documentation, increased transparency and more extensive subsequent obligations.

Schuldscheindarlehen can also be differentiated from notes issued as registered notes (Namensschuldverschreibung), which similarly represent a hybrid instrument with characteristics of both loan financing and financing through the issuance of bearer bonds, but which, unlike Schuldscheindarlehen, do not constitute a loan agreement, but rather securities in the broader sense.

Finally, Schuldscheindarlehen can be differentiated from other private placement products. Within the framework of the political efforts to improve access by companies to capital markets by developing a pan-European private placement market, the LMA, just as other associations, has published proposals concerning template documentation for pan-European private placement transactions. The template documentation published by the LMA provides for a private placement in the format of a loan or debt securities, each governed by English law. It depends on the requirements of the borrower/issuer and the investors which format is chosen.

The table below provides an overview of the key similarities and differences in the various types of financing (syndicated loans, Schuldscheindarlehen, bearer bonds and registered notes as well as LMA private placement products):

<table>
<thead>
<tr>
<th></th>
<th>Syndicated loan</th>
<th>Schuldscheindarlehen</th>
<th>Registered note</th>
<th>Bearer bond</th>
<th>LMA Private Placement Products</th>
</tr>
</thead>
<tbody>
<tr>
<td>Legal classification</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
<td>1) If &quot;loan&quot;-option chosen: Yes</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>2) If &quot;debt securities&quot;-</td>
</tr>
<tr>
<td>Security</td>
<td>No</td>
<td>No</td>
<td>Yes (in a broader sense)</td>
<td>Yes</td>
<td></td>
</tr>
<tr>
<td>---</td>
<td>---</td>
<td>---</td>
<td>---</td>
<td>---</td>
<td></td>
</tr>
<tr>
<td>Placement and transfer</td>
<td>Banking syndicate as lender</td>
<td>Private placement with institutional investors (banks, insurers, pension funds, investment management companies)</td>
<td>Private placement with institutional investors (banks, insurers, pension funds, investment management companies)</td>
<td>Private placement or public offer, institutional or private investors</td>
<td></td>
</tr>
<tr>
<td>Placement</td>
<td>Assignment / assumption of contract (generally assumption of contract)</td>
<td>Assignment / assumption of contract (cf. 2.5.2)</td>
<td>Assignment</td>
<td>In accordance with section 929 et seq. BGB, via clearing system</td>
<td></td>
</tr>
<tr>
<td>Transfer</td>
<td>No</td>
<td>No</td>
<td>No (generally)</td>
<td>Yes</td>
<td></td>
</tr>
<tr>
<td>Listing and clearing</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Creditor representation and majority decisions</td>
<td>Yes (via agent)</td>
<td>No (generally); the paying agent acts as the borrower's vicarious agent and not as the creditors' representative</td>
<td>No (generally)</td>
<td>Possible joint representation, in accordance with the German Bond Act (Schuldverschreibungsgesetz)</td>
<td></td>
</tr>
<tr>
<td>Creditor representation</td>
<td>Yes</td>
<td>No (generally)</td>
<td>No (generally)</td>
<td></td>
<td>Yes (via agent)</td>
</tr>
<tr>
<td>Majority decisions by creditors</td>
<td>Yes</td>
<td>No (generally)</td>
<td>No (generally)</td>
<td>Possibly, in accordance with the German Bond Act</td>
<td></td>
</tr>
<tr>
<td>Regulatory features</td>
<td>No</td>
<td>No</td>
<td>No (generally)</td>
<td>Yes (generally), in accordance with the Securities Prospectus Act</td>
<td></td>
</tr>
<tr>
<td>Prospectus obligation</td>
<td></td>
<td></td>
<td></td>
<td>No</td>
<td></td>
</tr>
<tr>
<td>Licensing requirement for borrower / issuer</td>
<td>Possibly as a deposit business</td>
<td>Possibly as a deposit business</td>
<td>Possibly as a deposit business</td>
<td>Possibly as a deposit business</td>
<td></td>
</tr>
<tr>
<td>Licensing requirement for lender / investors</td>
<td>Possibly as a lending business</td>
<td>Possibly as a lending business</td>
<td>No</td>
<td>Possibly as a lending business</td>
<td></td>
</tr>
</tbody>
</table>
1.4 Market observations

*Schuldscheindarlehen* can, in principle, be used by all types of borrowers, ranging from banks and companies to public sector institutions and, theoretically, private individuals. Moreover *Schuldscheindarlehen* can be used for a wide range of finance transactions, in particular for structured investments. The following market observations concentrate on *Schuldscheindarlehen* raised by companies.

1.4.1 Borrowers

*Schuldscheindarlehen* can be an attractive financing option for companies that require medium to long-term financing in the amount of approximately EUR 20 million to EUR 500 million. The instrument offers easy, inexpensive access to capital markets. *Schuldscheindarlehen* may, for example, be used to finance investments, acquisitions or core current assets. Because *Schuldscheindarlehen* are, in principle, issued through private placements and not in public offerings, companies can control the publicity surrounding the transaction.

1.4.2 Lenders/investors

Professional investors, including but not limited to credit institutions such as banks, savings banks (*Sparkassen*) and co-operative banks (*Volks- und Raiffeisenbanken*), as well as institutional investors, including insurance companies, investment management companies or pension funds act as lenders or investors in loan receivables created via a *Schuldscheindarlehen*. The majority of these investors are German banks and insurers, although there are increasing numbers of European and Asian investors. Registered notes are often used where the term of the agreement exceeds 10 years.

1.4.3 Flexibility

*Schuldscheindarlehen* carry varying maturities of typically between 2 and 10 years (e.g. 3, 5, 7 and 10 years), with different types of interest rates (e.g. subject to variable interest rates linked to the 6-month Euribor rate and fixed interest) and possibly denominated in various currencies (e.g. EUR and USD), are often raised in parallel within one placement process. Such a structure is capable of generating interest among various investor groups during the course of the transaction. Institutional investors, for instance, generally
prefer acquiring long-term loan receivables with fixed rates of interest, whereas banks often prefer medium-term loans with variable interest rates.

1.4.4 Trends in the corporate Schuldscheindarlehen market

The market for Schuldscheindarlehen made to corporate entities has grown considerably over the past few years. Its development has been particularly turbulent since 2007 in the wake of the financial crisis. When the bond markets more or less shut down for a substantial period of time, many German and foreign companies turned instead to Schuldscheindarlehen as an alternative means of financing. The primary market for such loans has proven to be very stable. In the years following the financial crisis an easing took place within the market for Schuldscheindarlehen leading to volumes ranging from EUR 4.4 billion to EUR 14.0 billion per year. According to ThomsonReuters the previous record volume from 2008 was surpassed in 2015. In total EUR 20.2 billion Schuldscheindarlehen were raised, mainly driven by their increasing acceptance by issuers as well as investors, their continuous use as a tool to take out acquisition loans and, from an issuer’s perspective, their temporary pricing advantages compared to publicly listed bearer bonds (Inhaberschuldverschreibungen).

Market trends: historical volumes
Market trends: volume by nationality

Not only German borrowers, but also companies from other countries, such as Austria or France, but also the Netherlands, Switzerland, Finland, Sweden, Great Britain, Belgium or Luxembourg make use of this market. As the strong growth in market volume mainly derives from the domestic market, the percentage of non-German borrowers has declined in 2015 though.

1.4.5 Bookbuilding

During placement of the Schuldscheindarlehen (the "bookbuilding" process), during which the loan documentation is made available to interested parties, potential investors are invited to bid for partial amounts of the loan receivables under the Schuldscheindarlehen. As a rule, potential investors
have four to six weeks to make a financing decision. The arrangers are in close contact with the investors during this period and assist them in the lending decision process by answering potential borrower or documentation-related questions. Borrowers normally use company presentations to convince interested investors directly of their creditworthiness.

The arrangers create an order book which records expressions of interest from potential investors and ensures that borrowers are kept regularly informed about the current status. Towards the end of the bookbuilding phase, the interested investors make binding offers. Each investor decides individually, within the framework provided for by the borrower and the arrangers, which amount of the loan, the tenor and the type of interest payable on the loan receivable it wishes to acquire. The interest rate is fixed separately for each maturity and then applies to all investors in the respective maturity. Investors' offers are scaled back in the case of oversubscription of the offer. Once the final allocation has been agreed, the arrangers inform each investor of its individual allocation.

1.4.6 Purpose of *Schuldscheindarlehen*

*Schuldscheindarlehen* are typically raised for corporate finance transactions (either general corporate purposes or (narrower) working capital purposes). The subsequent description in this guide focuses on these classic forms of *Schuldscheindarlehen*, ignoring *Schuldscheindarlehen* serving other purposes, such as the following:

The use of *Schuldscheindarlehen* is growing strongly in the areas of real estate, project and acquisition finance. In those areas, *Schuldscheindarlehen* are often secured and combined together with other finance instruments. As a consequence, in such cases further agreements need to be executed in addition to the *Schuldscheindarlehen*, in particular an intercreditor or a security trust agreement. Notably in the area of project finance, *Schuldscheindarlehen* or, with respect to long-term financing, registered bonds (*Namensschuldverschreibungen*) represent the capital market component of the overall funding structure, thus providing access to new types of investors as a financing source. In addition, institutional investors such as insurers or pension funds use *Schuldscheindarlehen* for the purpose of financing structured investments with embedded derivative elements.
1.5 Documentation standards

1.5.1 Volume and structure of documentation

_Schuldscheindarlehen_ are traditionally documented in a lean way similar to bonds. If banks or financially sound companies which have already issued bonds, or which have already set up their own debt issuance programme, also use _Schuldscheindarlehen_ to raise capital, the terms and conditions of the _Schuldscheindarlehen_ are generally aligned with terms and conditions of the bonds issued and/or the existing debt issuance programme.

_Schuldscheindarlehen_ are normally unsecured, under certain circumstances guaranteed, and typically merely contain clauses that the lender will rank equally or at least equally with other unsecured creditors and contain a form of negative pledge language.

With the growing popularity of _Schuldscheindarlehen_, and given the extent to which they are being used with increasing frequency for general corporate financing purposes in the capital markets, especially for financing medium-sized companies, the documentation in respect of representations and warranties, covenants (e.g. financial covenants), events of default, events of early redemption and conditions precedent is increasingly mirroring documentation used for syndicated loan agreements. Documentation for syndicated loan agreements, however, usually contains significantly more comprehensive terms and conditions. Documentation for _Schuldscheindarlehen_ may also include separate agreements between the borrower and a paying agent and calculation agent. In the event that the arranger assumes this administrative function, these arrangements are occasionally already provided for in the _Schuldscheindarlehen_ agreement.

1.5.2 Issuing Schuldscheine

The original method for entering into _Schuldscheindarlehen_ was for the borrower to issue _Schuldscheine_ containing the loan conditions. It is now increasingly the case that separate _Schuldscheine_ are no longer issued. Sometimes the first page of the loan agreement to be signed by the borrower is in the form of a _Schuldschein_. In addition to using the word “_Schuldschein_” the loan agreement in such cases contains wording which confirms the receipt of the loan and refers to the terms and conditions of the loan agreement. The loan is sometimes simply called "_Schuldschein-Darlehen_" and the loan agreement is referred to as a "_Schuldschein-Darlehensvertrag_".
without constituting a *Schuldschein* in the legal sense. In order to enforce any claim under such a loan, there is no need to submit the *Schuldschein* or underlying loan agreement.

In other circumstances, the loan agreement contains a *Schuldschein* specimen and provides that such *Schuldschein* is issued by the borrower following drawdown. When such a *Schuldschein* is issued, its safekeeping and potential adjustments in case of loan increases, repayments or partial or total assignments/transfers between investors need to be considered.

If, as is generally the case, the note takes the form of a simple confirmation by the borrower of having received a certain amount, this has no bearing on the lender’s obligation to demonstrate that the loan receivable exists in cases where this is disputed. The *Schuldschein* still makes it easier to demonstrate the drawdown of the loan receivable (as part of a documentary procedure for instance). Depending on the form it takes, the note may also constitute an acknowledgement of debt (*Schuldenanerkenntnis*) constituting the debt and thereby reversing the burden of proof.

1.5.3 Other features

In the event that the loan receivable is subsumed into an insurer’s guarantee assets, *Schuldscheindarlehen*, generally and as appropriate, include a set-off waiver required under German insurance supervision law (whereby the borrower waives its right to set-off vis-à-vis the lender). Loan receivables under *Schuldscheindarlehen* can also be used as central bank collateral if they meet the applicable criteria used by the European Central Bank for non-marketable collateral.

In case of an event of default, all of the creditors have an individual right to withdraw from their own loan amount under the loan agreement. They are not bound by the decision of the majority of the lenders, as they would be in the case of syndicated loans.

1.6 Placement standards

There are two models used when placing *Schuldscheindarlehen* in the market. Under the "direct model", the arranger acts solely as an intermediary and the loan agreement is agreed directly between the borrower and the investor(s) acting as lenders. The "indirect model" is used more often in practice and involves the arranger and/or the primary lender concluding the loan agreement in its own name and then transferring its own contractual position by means of a transfer of contract
or, following drawdown of the loan, an assignment of the repayment and interest claims as well as any ancillary or dispositive rights to such investor(s).

The arranger does not generally assume any placement risk and only works on a "best efforts" basis, i.e. where it makes its best efforts to ensure that a placement is successfully made. This is generally set out in a separate document between the arranger and the borrower. Sometimes the Schuldscheindarlehen itself contains provisions in this regard (with the amount available for drawdown often being based on the amounts actually provided by the investors).

1.7 Secondary market

Following the primary placement, loan claims under a Schuldscheindarlehen can generally be freely transferred. This means that investors are able to sell on any receivables they may have acquired. Since Schuldscheindarlehen are not listed instruments, they are mostly sold via telephone trading ("over the counter" / OTC). The liquidity of the secondary market for Schuldscheindarlehen cannot therefore be compared with the one for bonds. Investors generally pursue a "buy-and-hold" strategy.

1.8 Regulatory features

Borrowers’ notes issued under Schuldscheindarlehen are not classified as securities as defined in the WpHG and the WpPG or financial instruments as defined in the German Banking Act (Kreditwesengesetz, "KWG"). A short-term Schuldscheindarlehen may, however, be considered to be a money market instrument and thus a financial instrument.

In terms of regulatory requirements, particular attention must be paid as to whether any authorisation is required for conducting banking transactions or providing financial services and whether the parties need to have obtained the requisite authorisation (if any).

Whether the activities in the context of a Schuldscheindarlehen require a permit or licence largely depends on the following:

- Investors need to bear in mind that lending activities may require a permit or licence under German law. According to the Federal Financial Supervisory Authority (Bundesananstalt für Finanzdienstleistungsaufsicht, "BaFin") on what constitutes lending activities, a permit or licence is generally not required if the investor acquires the claim to repayment under Schuldscheindarlehen fully disbursed by way of assignment or assumption of contract. If, on the
other hand, the investor disburses the loan directly to the borrower, as a rule it requires a permit or licence to engage in such lending activities or it shall be limited to conducting activities as prescribed by the exceptions. For foreign lenders which are not focussed on the German market, they may, for example, fall within the exceptions as regards cross-border banking activities and/or financial services.

- Borrowers need to be aware of the fact that the activities may constitute deposit services which require a permit or licence under German law. The most notable exceptions to this are found where, instead of raising funds from the public, the borrower raises funds from institutional investors.

Depending on the specific structure of the transaction, other factors outlined in the KWG (e.g. brokering of deposit business with enterprises domiciled in a non-EEA state (non-EEA deposit brokering), or other laws (e.g. brokering loans, collecting loan receivables) may constitute activities requiring a permit or licence.

**1.9 Advantages of Schuldscheindarlehen**

From the borrowers' perspective, raising funds through a *Schuldscheindarlehen* has various advantages. For example, it enables companies, which have hitherto been unable to directly tap the capital markets, to raise funds from outside their core banking group, thereby diversifying their creditor base. If required, *Schuldscheindarlehen* enable borrowers to raise capital with discretion/confidentiality. The issuing costs for *Schuldscheindarlehen* are significantly lower than those for corporate bonds, making *Schuldscheindarlehen* an economically attractive proposition even for low-volume issues. The comparably low transaction costs and consequential costs can be attributed, among other things, to a prospectus not being required and the fact that no fixed costs are incurred for a listing or any other associated disclosure obligations.

The documentation itself can be tailored specifically to the needs of the borrower and the lender(s). Offering varying maturities in parallel improves the maturity profile of the borrower's financial liabilities. Each maturity is subsequently repaid separately by the borrower. Often existing documentation can also be used for subsequent transactions.

*Schuldscheindarlehen* afford lenders access to the debt capital of companies not available in the public debt markets. Many investors are attracted by the fact that *Schuldscheindarlehen* do not need to be assessed on a mark-to-market basis. Lean documentation can be considered as another advantage.
2. **DRAFTING DOCUMENTATION**

The main drafting elements of *Schuldscheindarlehen* typically used in the market are set out below. The wide variety of options means that no specific recommendations for standard clauses for *Schuldscheindarlehen* documentation are made here. Instead, the aim of this Guide is to highlight market practice and to introduce interested parties to *Schuldscheindarlehen* and the documentation typically associated with them.

2.1 **Key contractual provisions**

2.1.1 Definitions, drawdown

*Schuldscheindarlehen* agreements normally contain a definitions section at the beginning of the agreement. The drawdown procedures, including but not limited to, any conditions precedent to drawdown are set out therein and may require the submission of various documents including corporate law resolutions, a commercial register extract, a list of authorised signatories, a power of representation, legal opinions in respect of the validity and enforceability of the documentation and/or the borrower's capacity or with respect to non-German borrowers - legal opinions regarding such borrower's existence, its capacity and/or authority to raise the *Schuldscheindarlehen* and perform its obligations thereunder and the due representation when executing the *Schuldscheindarlehen* (capacity, authority, due execution) or combinations of such legal opinions and confirmation by the board of directors/management in respect of certain warranties given.

2.1.2 Interest

One of the key provisions concerns the different types of interest rates that may apply, namely: fixed interest, variable or structured interest rates (including zero-coupon structured notes). The provisions concerning the calculation of the amount of interest (such as the day count fraction, adjustment or non-adjustment of the interest periods, the length of the interest periods etc.) are set according to market standards developed for debt securities and syndicated loans. Sometimes they contain an agreed interest rate step-up provision which is triggered when certain financial ratios are exceeded ("Step-Up Provision"). The interest rates and the amount of interest payable are, as a rule, calculated by the borrower's paying agent/calculation agent.
2.1.3 Repayment

_Schuldscheindarlehen_ are generally loans with a fixed maturity. The provisions stipulate that they can either be (i) repaid on the loan's maturity date or (ii) prior to the maturity date. The outstanding nominal amount of the _Schuldscheindarlehen_ is repayable on the agreed maturity date. Insofar as a borrower’s note is issued, it must be immediately returned to the borrower upon repayment of the _Schuldscheindarlehen_ and/or it is terminated by the custodian subject to the borrower’s prior consent. The parties may agree to an ordinary right of termination which may be invoked by the lender or the borrower. The documentation may also contain other options/rights of termination which may be invoked under special circumstances (cf. 2.4.1). In the event that the borrower has such further rights of termination, the documentation may stipulate that early repayment penalties must be paid to the lender (_Vorfälligkeitsentschädigung_).

2.1.4 Payments

Provisions regulating payments under _Schuldscheindarlehen_ tend to be of a technical nature. In practice, it is important to note that payments are not made via a clearing system for remittance to creditors, as is the case with bearer bonds (_Inhaberschuldverschreibungen_). Instead, payments are made directly or via a paying agent to each investor. The documentation therefore usually contains the lender’s bank account details, provisions with regard to compliance with money laundering regulation and know-your-customer processes, as well as postponement of payment dates (business day conventions). It may also contain default interest provisions insofar as the parties wish to deviate from the statutory provisions (sections 288 BGB, 352 HGB). The borrower may appoint a paying agent to effect such payments to the lender(s) on its behalf. The paying agent acts as the borrower's agent/vicarious agent (_Erfüllungsgehilfe_) in this respect. Accordingly, payments made by the borrower do not already have a debt-discharging effect at the time payment is made to the paying agent, but rather at the time of receipt of payment by the respective lender.

2.1.5 Set-off waiver

A set-off waiver provision can typically be found in _Schuldscheindarlehen_ agreements, taking due account of a specific group of investors active in the
Schuldschein market. Pursuant thereto, in the event that an insurance company is the lender, the borrower waives its right to set-off vis-à-vis the lender in the event that the loan receivable is subsumed into an insurer's guarantee assets (cf. section 124 German Act on the Supervision of Insurance Undertakings (Versicherungsaufsichtsgesetz, VAG)). This provision also applies to a situation where the Schuldscheindarlehen is subsumed in a Pfandbriefbank's covered funds. Similar issues corresponding to the potential scenarios specified therein may apply analogously in foreign jurisdictions. The set-off waiver should normally also be worded to cover the hypothetical scenario of the lender going into insolvency. It may also be advisable to obtain legal advice to check on a case-by-case basis whether this provision is also deemed to apply to a hypothetical insolvency scenario in line with applicable foreign insolvency law provisions.

2.1.6 Guaranteed Schuldscheindarlehen

Insofar as payment liabilities of the borrower from Schuldscheindarlehen are guaranteed, provisions relating to such guarantee can be found in the Schuldscheindarlehen agreement. The guarantee declaration provided by the guarantor may be incorporated into the Schuldscheindarlehen agreement which is then also signed by the guarantor. The guarantee usually takes the form of a contract for the benefit of third parties (Vertrag zugunsten Dritter), i.e. the respective lender at a certain point in time. In any event, an assurance should be obtained that the guarantee also covers any transfers of the Schuldscheindarlehen to ensure that acceding/new loan creditors can benefit from the guarantee. The corporate law, tax and insolvency law issues that could potentially arise in connection with guarantee declarations from group companies should be reviewed on a case-by-case basis.

Unlike guarantees, sureties (Bürgschaften) are rarely used. This is primarily due to the accessory nature of warranties and the statutory regulations governing sureties.

2.1.7 Increased refinancing costs for lenders

Insofar as banks act as lenders, it is not uncommon for Schuldscheindarlehen to contain provisions allowing the bank to pass on any increased refinancing costs incurred during the term of the loan to the borrower. If the contractual provisions permit, the lender may be able to claim for any increased refinancing costs vis-à-vis the borrower which have arisen either as a reduction of the underlying return from the Schuldscheindarlehen or due to
the lender incurring additional or increased costs. Insofar as the lender claims for these increased refinancing costs, the borrower may be granted a right to terminate the Schuldscheindarlehen. Alternatively, Schuldscheindarlehen agreements can contain provisions which oblige the parties to enter into negotiations with respect to the assumption of increased refinancing costs.

2.1.8 Taxes

Schuldscheindarlehen documentation may also address withholding tax on interest and/or principal payments by the borrower. Normally, the borrower assumes the risk of withholding tax being imposed and undertakes to pay additional amounts to ensure that the lender ultimately recovers its principal and interest in full. Here again, there are certain exceptions to accommodate situations in which withholding tax issues arise for reasons that are in the sphere of the lender and that could have been avoided. In the event that the borrower is required to pay additional amounts, it is usually entitled to terminate the Schuldscheindarlehen prematurely (on the basis of the relevant provisions in the Schuldscheindarlehen agreement), however, often only in return for payment of compensation for early termination.

2.2 Representations and warranties

There are no standards in the Schuldschein market applicable to representations and warranties. The categories of representations and warranties that are commonly found in corporate Schuldscheindarlehen are listed below:

- **compliance with corporate law**, relating to the identity of the borrower (e.g. confirmation of the borrower’s existence, that the borrower is authorised to raise funds via the Schuldscheindarlehen, that the Schuldscheindarlehen agreement is valid, that all requisite licences and approvals have been procured; that neither the statutes, articles of association nor any other agreements to which the borrower is a party will be breached by it entering into a Schuldscheindarlehen agreement, and that no public institutions need to be notified and no registration is required to achieve the effectiveness of the Schuldscheindarlehen);

- **the borrower's financial situation and creditworthiness** (e.g. confirmation that no default has occurred, confirmation that the latest audited annual financial statements are accurate and complete, confirmation that no legal proceedings are pending against the borrower which are capable of having an adverse effect on the borrower’s financial situation);
• the accuracy of all (key) aspects of information which the borrower has made available; and

• confirmation of compliance with anti-money laundering laws.

2.3 General undertakings/covenants

There are no market standards when it comes to undertakings either. In contrast to representations and warranties, the scope of undertakings and covenants essentially depends on the borrower's creditworthiness. These normally fall under the following categories:

• Disclosure duties regarding the borrower's financial situation (e.g. the borrower undertakes to make available annual, half-year and quarterly financial statements, other material information pertaining to the borrower, as well as information which is relevant for the assessment of the borrower's financial situation);

• Other information disclosure duties (e.g. providing notification of any act or occurrence entitling a party to extraordinarily terminate the agreement (außerordentliche Kündigung), of a change in business operations, in the event of a change of control or of a change of the borrower's legal form; providing information required by the lender to comply with supervisory law provisions (if applicable);

• Cease-and-desist obligations (e.g. an assurance not to alter the scope of the borrower's business, not to conduct certain transactions such as disposals of assets, acquisitions or certain measures such as corporate restructurings, not to incur further liabilities; negative pledge clauses, pursuant to which the borrower warrants, for the term of the Schuldscheindarlehen, not to provide further assets as security without enabling the lenders to participate in such security at the same time and on a pari passu basis, are particularly relevant in this context (such negative pledge clauses usually contain appropriate carve outs));

• Financial key figures (usually contains the obligation to maintain certain financial ratios throughout the term of the loan including compliance with leverage ratios (net debt/EBITDA) or minimum capitalisation requirements (equity capital/balance sheet total), the related testing periods (yearly/half-yearly/quarterly); depending on the specific arrangement, non-compliance
with such obligation may result in an event of default or in a margin increase ("margin step-up").

As in the case of representations and warranties as well as in the context of general undertakings and covenants, it should be noted that a breach usually entitles the lender to terminate the agreement for cause without notice. Each lender shall be entitled to exercise its right of termination in the amount corresponding to its partial loan receivable. In the event that a company experiencing financial difficulties is restructured, the Schuldscheindarlehen will rank equally with a syndicated loan and any capital market instruments issued by the company. The Schuldscheindarlehen is generally not included in agreements between individual creditor groups (intercreditor agreement). Lenders can safeguard their interests in the course of such a restructuring independently of other creditors, as they are not subject to majority decision-making by other creditors.

2.4 Grounds for termination

Schuldscheindarlehen agreements may provide various grounds for termination. It is important to note that there are also statutory events of default.

2.4.1 Special grounds for termination

Apart from the aforementioned events for early redemption (ordinary right of termination, right to termination upon payment of the additional amounts due to withholding tax, right to terminate as a result of claiming for increased refinancing costs) there are other grounds for termination worth mentioning which are intended to take special circumstances into account under which the parties cannot be expected to adhere to the Schuldscheindarlehen, including the following:

- Legal amendments which have a materially adverse effect on the other party. These provisions may include prohibitions on legal transactions (Vertragsverbote) brought about by any subsequent amendments to statutory provisions. They may also cover adverse changes under regulatory, accounting or tax law. Termination provisions (Lösungsklauseln) in respect of regulatory capital requirements which enable banks to prematurely terminate the agreement where loans are granted by banks and changes in the regulatory and capital adequacy requirements occur, are sometimes included.
• Corporate law measures/change of control. These provisions provide that the lender shall be entitled to terminate the agreement if there are any changes to the ownership / shareholder structure resulting in a change of control of the borrower. In order to avoid the risk of a cross default on a company's other debt instruments occurring, a change of control can be defined as constituting a special ground for termination (Beendigungseignis) as opposed to termination for cause without notice (außerordentlicher Kündigungsgrund).

2.4.2 Grounds for termination for cause without notice

Grounds for termination for cause without notice which are usually agreed by the parties to the Schuldscheindarlehen may include, inter alia:

• non-payment of an amount due;

• other contractual breach (including but not limited to, a breach of representations and warranties and/or general undertakings and covenants);

• cross-default/cross-acceleration, whereby the financial liabilities referred to are specified and subject to de minimis provisions;

• change of control (if not constituting a special ground for termination (Beendigungseignis); see above);

• a party has become insolvent, a petition has been filed for the institution of insolvency proceedings, grounds for the institution of insolvency proceedings arise.

In the event that grounds for termination for cause without notice arise, it is usually possible for the lender to terminate the agreement at any time without observing any notice period and the Schuldscheindarlehen becomes immediately due and payable. It should be noted in this respect that, in the case of several lenders, each lender may, as a rule, demand immediate repayment of its portion of the Schuldscheindarlehen. A lender is not bound by the exercise of the right of termination by another lender which has likewise invested in the Schuldscheindarlehen. The provisions contain no thresholds which need to be exceeded in order for the agreement to be terminated for cause without notice. In the event that the agreement is terminated for cause without notice, the borrower usually has to pay compensation for early termination.
2.4.3 Statutory grounds for termination

German lending regulations prescribe further statutory grounds for termination which may only be partially waived by the parties including section 490 para 1 BGB, which provides that the lender may give notice of termination of the loan agreement if there is or threatens to be a substantial deterioration in the financial circumstances of the borrower or in the value of a security given for the loan as a result of which the repayment of the loan is jeopardised even if the security is realised.

In the case of continuous contractual obligations (Dauerschuldverhältnisse), pursuant to section 314 BGB, each party may terminate a contract for cause without notice. A cause is deemed to exist if specific facts and circumstances exist that, taking into account the interests of both parties, render it unreasonable to expect the terminating party to continue the contractual relationship. The Schuldscheindarlehen agreement provides typical examples of when cause is deemed to be constituted, however, it should be noted that this is a non-exhaustive list of examples.

Pursuant to section 489 para 1 BGB, the borrower may terminate a Schuldscheindarlehen contract under which a periodically fixed (i.e. pegged) interest rate has been agreed (1) if the pegging of the interest rate ends prior to the time determined for repayment and no new agreement is reached on the interest rate, observing a notice period of one month, to end at the earliest at the end of the day on which the pegging of the lending rate ends; (2) in any case at the end of ten years as of the loan being paid out in full, observing a notice period of six months.

Pursuant to section 489 para 2 BGB, the borrower may terminate a loan contract with a variable interest rate at any time upon three months' notice. For the avoidance of doubt, where Schuldscheindarlehen carry an interest rate which refers to a benchmark interest rate predetermined for the respective interest period (e.g. 6-months-EURIBOR plus a defined margin), such Schuldscheindarlehen may be terminated in accordance with section 489 para 1 No. 1 second subclause BGB (even though they are usually referred to as “floating rate”).

The borrower’s right of termination under section 489 paras 1 and 2 BGB may not be excluded or rendered more difficult by contract (including neither by
penalty nor compensation duties). This does not apply to loans to the Federal Government, to a special fund of the Federal Government, a federal state, a municipality, an association of municipalities, the European Communities or foreign regional or local authorities.

2.5 **Transfer**

A *Schuldscheindarlehen* is transferable by way of assignment (*Abtretung*) or by way of assumption of contract (*Vertragsübernahme*).

2.5.1 **Assignment**

The relevant partial amount of the claim for repayment under the loan and the interest claims accruing thereon on a pro rata basis are transferable by way of assignment. An assignment usually also entails, to the extent legally permissible, the transfer of all ancillary and dispositive rights; the assignee should be authorised to enforce claims in its own name for ancillary and dispositive rights not transferred to it.

The initial lender remains the borrower's formal contracting partner in the first instance. However, according to market practice, all dispositive rights (including the initial lender's right of termination) may be exercised without any involvement by the initial lender.

As a rule, a *Schuldscheindarlehen* agreement contains a written form requirement and the relevant assignment agreement will be in writing. It also usually provides for a declaration of assignment to be sent to the borrower or paying agent. The declaration should usually be sent 10 to 15 business days prior to the next day of payment, at the latest. In the event of failure to send the declaration in a timely manner, the borrower may render payments to the assignor with debt-discharging effect. The effectiveness of the assignment is not conditional on the *Schuldschein* being handed over.

Transferability by assignment may be made subject to contractual limitations. In particular, minimum amounts and consent requirements may be agreed. Assignments to institutional investors are generally not subject to any contractual consent requirements. In the event that the *Schuldscheindarlehen* receivable is used for the tied-up capital of the restricted assets of an insurance company, stipulating a consent requirement is generally not accepted by regulatory bodies. In case the *Schuldscheindarlehen* receivable shall be used as collateral with the European Central Bank, transferability by assignment may not be restricted either.
The assignee is, in principle, obligated to accept the borrower’s receivables being set-off against the initial holder of a receivable, including but not limited to, the initial lender. As a rule, however, the right to set-off is significantly restricted by a contractual exclusion of set-off contained in the Schuldscheindarlehen agreement. Statutory set-off restrictions may potentially apply insofar as the Schuldscheindarlehen receivable is used as collateral for a German Pfandbrief or an insurer’s restricted assets.

Insofar as the borrower has furnished collateral, the following distinction needs to be made: (i) accessory collateral security (such as a surety, pledge over accounts or share pledges) pass to the assignee upon transfer of the assigned Schuldscheindarlehen receivable, insofar as they are used to collateralise this receivable; (ii) other collateral must be transferred separately (such as trade receivables from goods and services that have been transferred by way of assignment for security (Sicherungszession von Forderungen aus Lieferung und Leistung) or land charges (Grundschulden)). The agreement may also provide for loan collateral to be managed by a security trustee.

2.5.2 Assumption of contract

Unlike a straightforward assignment of claims (payment claims under the Schuldscheindarlehen agreement), an assumption of contract also involves the transfer of the contractual obligations incumbent on the party acting as lender, with the lender transferring those obligations and withdrawing entirely from the Schuldscheindarlehen agreement. In the event of a partial assumption of contract, the party to which the obligations are being transferred only assumes those obligations relating to the relevant amount under the loan agreement. Any assumption of contract means that the receiving party becomes the sole party entitled to exercise any rights to alter the legal relationship (including any right of termination), with this entitlement being restricted to the partial amount transferred in the case of partial assumptions of contract.

The assumption of contract does not have to take a specific form, but if the loan agreement specifies that it does, then the parties need to comply with these requirements. If the assumption of contract does not take the form of a tripartite agreement and instead involves an agreement between the original lender and/or transferring lender and the recipient, the consent required from the borrower is usually provided in advance in the Schuldscheindarlehen agreement. No statutory requirements of form exist for any consent to be
issued separately, although the borrower's consent is often linked to various other requirements (such as the right to withhold consent in certain cases and minimum amounts for the transfer).

If borrowers provide their prior consent to the transfer of contract, they are entitled to protection against set-off in accordance with the assignment provisions, although this protection can be significantly restricted by means of a contractual ban on set-off or – in specific cases – statutory limits on set-off.

The transfer of loan collateral in the event of the assumption of contract is equivalent to a transfer by way of assignment.

NB assumption of contract, as referred to in this Product Guide, is German law specific.

2.5.3 Reconciling assignment / assumption of contract

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<tr>
<th>Issue</th>
<th>Assignment</th>
<th>Assumption of contract</th>
</tr>
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<tbody>
<tr>
<td>Contractual obligations incumbent on the initial lender</td>
<td>- remains a party to the contract</td>
<td>- assignee becomes a party to the contract</td>
</tr>
<tr>
<td></td>
<td>- if the contract does not take a specific form (authorisation and the like) no involvement in terminations required</td>
<td>- no involvement in terminations etc. required</td>
</tr>
<tr>
<td>Applicable law</td>
<td>- German law</td>
<td>- German law</td>
</tr>
<tr>
<td>Form requirement</td>
<td>- only if contractually provided for in the Schuldscheindarlehen agreement</td>
<td>- only if contractually provided for in the Schuldscheindarlehen agreement</td>
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<tr>
<td>Transfer restrictions</td>
<td>- may be contractually provided for</td>
<td>- may be contractually provided for</td>
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<tr>
<td>Right to receive borrower's note</td>
<td>- upon transfer of Schuldscheindarlehen</td>
<td>- upon transfer of Schuldscheindarlehen</td>
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<tr>
<td>Set-off</td>
<td>- Set-off possible unless agreement contains a</td>
<td>- Set-off possible unless agreement contains a</td>
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As far as the legal status of the assignee is concerned, there is ultimately no significant difference between the standard contractual terms used in practice.
3. **CHOICE OF LAW AND JURISDICTION**

3.1 **Choice of law**

A *Schuldscheindarlehen* is conditional upon being governed by the laws of the Federal Republic of Germany. Only in this case does the meaning of the underlying legal concepts of a *Schuldscheindarlehen* become clear and the terms and conditions correspond to the usual expectations of market participants.

Rome I Regulation ((EC) Regulation No. 593/2008) establishes uniform choice-of-law rules for determining the law applicable to contractual obligations in the European Union (EU). The parties to a *Schuldscheindarlehen* are, in principle, free to choose the governing law.

The parties are free to choose German law as the law governing their contractual obligations even if the borrower and lender have their corporate seat outside Germany. If, at the time of choosing the governing law, no connection to Germany exists, the mandatory statutory provisions of the national laws of the country which would apply without any choice of law shall apply. Comparatively minimal requirements exist as regards being connected with a country. For instance, the fact that the arranger has its corporate seat in Germany or that the *Schuldscheindarlehen* is intended to be transferred (also) to German investors may be deemed to constitute a sufficient link to Germany.

Generally speaking, in the case of international transactions, special criteria regarding the connection to a country may be imposed due to the application of the mandatory provisions of law/rules of another country such as monetary and exchange regulations. Such rules apply independently of the choice of law made by the contracting parties. In addition, the public policy (*ordre public*) of the country of the court before which an action is brought may lead to restrictions. However, before German courts, the public policy reservation has no effect if the *Schuldscheindarlehen* is governed by German law.

3.2 **Choice of German jurisdiction**

In practice, *Schuldscheindarlehen* agreements often contain a jurisdiction clause in favour of German courts. It is generally advisable to choose German courts to ensure the proper settlement of any disputes arising under *Schuldscheindarlehen* agreements. This is due to the fact that German law is applicable and the provisions of the *Schuldscheindarlehen* agreement are, if applicable, to be construed in
accordance with the practices of comparable Schuldschein transactions. German courts are considered to have strong expertise in dealing with such matters.

The effectiveness of the choice of German courts having jurisdiction is governed by Brussels I Regulation ((EC) Regulation No. 44/2001 and/or the Revised Regulation (EU) No. 1215/2012). Pursuant to this Regulation, the parties to a Schuldscheindarlehen agreement are at liberty to confer on a German court or the German court's jurisdiction to settle any disputes arising thereunder. In the event of any such agreement between the parties conferring jurisdiction, exclusive jurisdiction is conferred, unless stipulated otherwise by the parties. The agreement conferring jurisdiction should be stipulated in writing in the Schuldscheindarlehen agreement.

In the event that the Brussels I Regulation is not applicable in individual cases (domestic situations, matters falling outside the remit of the EU) and that German civil procedural law applies independently, this does not, in practice, have any ramifications on Schuldscheindarlehen agreements. Accordingly, tradesmen, legal persons under public law or a public law special fund are always entitled to confer jurisdiction on a German court without having to comply with any special form requirements. As a rule, the lender and the borrower are deemed to be tradesmen for this purpose, particularly if they are corporations or partnerships.