

GERMANY

LAW AND PRACTICE:

p.3

Contributed by Heuking Kühn Lüer Wojtek

The 'Law & Practice' sections provide easily accessible information on navigating the legal system when conducting business in the jurisdiction. Leading lawyers explain local law and practice at key transactional stages and for crucial aspects of doing business.

DOING BUSINESS IN GERMANY:

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Law and Practice

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Heuking Kühn Lüer Wojtek is a partnership of about 350 lawyers, tax advisers and civil law notaries, with eight offices in Germany and offices in Brussels and Zürich, making it one of the major commercial law firms in Germany. It supports international clients and co-ordinates work in various jurisdictions, collaborating with leading law firms interna-

tionally on a "good friends basis." About 40 to 45 lawyers predominately in Frankfurt, Cologne and Düsseldorf regularly advise Fintech companies on relevant German law matters, in particular banking regulatory, corporate, capital markets, financing rounds and M&A transactions.

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Dr Günther M Bredow LLM, is a partner who specialises in corporate finance in the German market and has advised on numerous significant transactions, including large portfolio acquisitions, asset-backed securitisations, IPOs and

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1. Fintech Market

1.1 The Development of Fintech Products and Services

The number of German Fintech companies has rapidly risen over the last couple of years. It is estimated that there are already about 500 Fintech companies active in Germany. Correspondingly, investment volume into German Fintech companies, by venture capital and strategic investors, has risen sharply in the last couple of years.

The large majority of German Fintech companies are active in the areas of:

- payment solutions;
- lending/deposits;
- investech/robo advice;
- capital raising; and
- Insurtech.

Germany is the second-largest Fintech market in Europe after the UK and Germany is rapidly catching up internationally. Most of the German Fintech companies are based in Berlin, Frankfurt, Munich and Hamburg but also in Düsseldorf, Cologne and many other cities due to the decentralised overall economy in Germany. It is expected that Frankfurt will play a dominant role in this regard in Germany given that it is already the financial centre in the country, with

many European institutions such as the European Central Bank on the ground.

A number of German Fintech companies offer their products and services only outside the country for regulatory reasons given, for instance, the strict banking licence requirements applicable in the country, which are more relaxed in many other jurisdictions.

1.2 The Market for Fintech Products and Services

Due to the already large number of Fintech companies in Germany, the products and services offered by these companies cover a broad spectrum of financial activities. German Fintech companies are in particular active in payment/forex services (for example, online/mobile payment solutions, forex trading and services, virtual currencies/coins/tokens, e-money and wallets as well as payment infrastructure providers, increasingly also using blockchain technology), investments (in particular robo advice and social trading applications), lending/deposits (for example, peer-to-peer (P2P)/marketplace lending, micro loans, new factoring services, online banking, corporate finance and corresponding services such as online/video identification), capital raisings (for example, crowd investment platforms, crowdfunding and alternative capital platforms) and Insurtech (for example, big data analytics, mobile platforms, digital sales and damage auction platforms).

According to a fairly recent (October 2016) and comprehensive study on the German Fintech market conducted by Prof Dr Gregor Dorfleitner and Prof Dr Lars Hornuf on behalf of the German Federal Ministry of Finance, the total market volume of Fintech businesses in Germany in the financing and wealth management sectors amounts to about EUR2.2 billion, whereas total transaction volume in the Fintech payment solutions market amounted to EUR17 billion. According to this study, almost all Fintech sectors in Germany enjoyed high growth rates over the last couple of years with particularly strong growth rates in the robo advice market, which grew about tenfold between 2007 and 2015. More importantly, the study forecasts further growth in the total market volume of Fintech companies in Germany from about EUR58 billion in 2020 to approximately EUR97 billion in 2025.

1.3 The Key Market Participants in the Specified Activities

According to the October 2016 study, a total of 433 Fintech companies were identified in Germany, of which 346 were already or still actively trading. The study stressed that about 87% of the surveyed financial institutions already co-operate with Fintech business, a trend that is expected to increase.

A considerable number of financial institutions and other strategic and financial investors have set up investment

funds and entities that focus on investments in Fintech start-ups as well as established Fintech companies. For instance, in autumn 2015, Deutsche Börse acquired the Frankfurt-based Fintech company 360T, which provides a heavily used forex trading platform, for a consideration of more than EUR700 million.

Other German Fintech companies that received considerable funds from various investors include Auxmoney and Kreditech (both lending), N26 (mobile bank account/lending), Orderbird and Payleven (both payments), and recently Fastbill (software as a service/invoice services). Well-known players from the robo advice and investment space in Germany include easyfolio, Visualvest, Vaamo and Weltsparen (social trading, robo advice, investments and deposits), barzahlen, sum up and cringle (payments), seedmatch (crowdfunding), and Clark (Insurtech).

There are already well-functioning Fintech ecosystems established in many of the larger cities in Germany providing advice, office space, funds and co-operation opportunities to Fintech companies through a network of corporate venture entities, in particular established by banks; incubators also offering office and co-working spaces; advisers; and investors across the board. These ecosystems often lead to further growth and co-operation in the Fintech industry in Germany.

1.4 Fintech Technologies/Companies

While a complete displacement of traditional financial service providers by Fintech companies cannot yet be observed in Germany, Fintech companies have already been able to capture a substantial market share, as evidenced by the aforementioned 360T, which successfully gained large numbers of corporate customers who traditionally conducted their FX business with their *Hausbank*. It is also expected that the market share of robo advisers will eventually constitute a substantial part of the German retail investment market.

1.5 Partnerships Between Traditional Institutions and Fintech Companies

Digitalisation and Fintech activities are seen as the path to the future by most of the traditional financial institutions active in Germany. As mentioned above, almost 87% of financial institutions already co-operate with Fintech businesses. In this context, most of the German banks regard Fintech companies as less a threat to their business model than an opportunity to drive innovation and digitalisation. Companies such as Deutsche Börse AG, Deutsche Bank AG, ING-DiBa and Commerzbank AG are active in Germany with regard to co-operation with Fintech companies. While some banks have already acquired Fintechs or formed joint ventures (Deutsche Boerse did both, for instance) or contractual ties with Fintechs, others have launched their own

accelerator programs (Commerzbank, for example) or offer Fintechs financial and technical support.

1.6 Approach to Fintech Innovation

German jurisdiction is friendly to Fintech companies in offering a reliable and regulated framework. While Germany offers no 'regulatory sandbox' such as the FCA in Britain does, Germany offers a level playing field for all market participants, including Fintechs, which enables consumers to establish trust vis-à-vis new market entrants.

The German Federal Financial Supervisory Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht*, BaFin) provides some general regulatory guidance in particular for Fintech companies. An internal BaFin task force has been established so that specific questions of new market entrants can be addressed in a meaningful way. BaFin also provides Fintech-specific FAQs on its website (www.bafin.de).

1.7 Laws or Policy to Encourage Innovation

Most recently, the German Federal Ministry of Finance has established a Fintech Council consisting of representatives of BaFin, various federal ministries, Fintech companies, banks and insurance companies, as well as scientists active in the digitalisation of the financial industry. The main objective of this Fintech Council is to advise the German Federal Ministry of Finance on questions relating to Fintech trends, in particular technological developments, risks and opportunities with a common aim to improve the overall situation for Fintech businesses and to encourage innovation in this sector. During the first session of the newly formed Council that took place on 22 March 2017, topics relating to blockchain technology, the technical basis for virtual currencies and digital identity were addressed.

2. Regulation

2.1 Regulatory Regimes for Specified Activities or Fintech Companies

Fintech companies will have to comply with the same national regulatory regime as other companies active in the financial sector in Germany. As the financial regulatory regime is federal law, the regulatory requirements are the same for all Fintech companies in the country. Depending on the specified activities in which the relevant Fintech company is active, the regulatory regime is different.

Payment

Fintech companies that provide mobile payment solutions, payment processing services or prepaid card services may require a licence under the German Payment Service Supervision Act (*Zahlungsdienstleistungsaufsichtsgesetz*, or ZAG). The requirement to have a licence depends on the structuring of the payment process and which parts of the payment process

are performed by the Fintech company itself. The German financial regulator, the Federal Financial Supervisory Authority, has issued the general rule that if the Fintech company takes possession of client money in the form of cash or in bank accounts, it will probably require a licence for payment services or for electronic money (e-money) business.

In such cases it is likely that the Fintech company performs money remittance business, including the Fintech company having possession over the funds of the user of its service and forwarding the money to another user or account of the same user.

If the Fintech company is just providing the technology for the payment process and is not involved in the payment process itself, it may make use of the exemption from the Payment Service Act for technology service providers. The exemption requires that the Fintech company is providing its services directly to the relevant payment provider and has no contractual relationship with the users of the service of the payment provider.

Most of the German Fintech companies that are active in the payment sector have partnered with established and licensed payment service providers or banks to provide their services. In such collaborations the Fintech companies provide the front-end to the users (in form of an app, for example) but the actual payment service is provided by the established bank or payment service provider. Although the Fintech company is not providing payment services in such a set-up, it may still be affected by the regulatory regime as the payment service provider is outsourcing activities to the Fintech company that are included in the organisational structure of the payment service provider. To allow the payment service provider to outsource activities to the Fintech company, it will have to comply with the organisational requirements of the payment service provider.

Furthermore, if the provided service includes e-money solutions (e-money is electronically saved monetary value in the form of a claim against the issuer, issued in exchange of money to perform payment services), like prepaid cards, the Fintech company may qualify as an e-money agent if it is involved in the distribution of the e-money, which is the case in most collaborations. The e-money issuer has to notify BaFin about its e-money agents and provide proof that the e-money agent is trustworthy and sufficiently qualified (fit and proper). Furthermore, the e-money agent has to comply with the requirements of the German Anti-Money Laundering Act (*Geldwäschegesetz*, or GwG).

If the Fintech company decides to provide the payment service by itself or to issue e-money, it will have to apply for a licence under the German Payment Service Act. The licence application will have to include a description of the intended

business model; a business plan; a description of the internal control systems, including a risk management system and how the payment service provider ensures compliance with the applicable laws; a description of the organisational set-up of the Fintech company, including any agents or outsourcing partners; and information about the managing directors, the holders of major participations (10% or more of the capital or voting rights) in the Fintech company and the Fintech company itself.

The Fintech company will have to have two managing directors, unless it is a small company, who have to be trustworthy and sufficiently qualified. To be sufficiently qualified, managing directors must have adequate theoretical and practical knowledge of the business concerned as well as managerial experience. The theoretical and practical knowledge has to be proved by the education and prior professional activities of the relevant managing directors. A person with managerial experience is deemed to be someone who has worked in a company providing payment services, comparable financial services or conducting banking business at top management level or one level below top management level.

Furthermore, the Fintech company will have to provide evidence that it has sufficient funds to run the business.

Lending/Crowdfunding

The regulatory regime applicable to crowdfunding depends on the structure of the platform and the contractual agreements. Crowdfunding platforms are designed in different ways:

- donation-based crowdfunding – users of the platform donate money to a specific project within a set timeframe, without receiving anything in return;
- rewards-based crowdfunding – the users receive a symbolic non-monetary reward;
- loan-based crowdfunding (crowd lending) – users are promised repayment, with or without interest; and
- crowd investing – users receive an interest in the financed project's future profits, or equity or debt instruments if the investment involves securities.

Crowdfunding projects structured as donation-based or rewards-based projects are not subject to regulatory regulations.

Lending and crowdfunding platforms operated by Fintech companies are typically structured in a way such that the Fintech company is broking the relevant product on the platform.

Crowd Lending

The operation of a P2P lending platform in the form of broking of loans does not require a licence under the German

Banking Act (*Kreditwesengesetz*, or KWG), as the Fintech company is not granting any loans, but the broking of loans requires a licence under the German Industrial Code (*Gewerbeordnung*, or GewO). The regulatory regime of the German Industrial Code is not comparable to supervision by BaFin. Licences under the German Industrial Code will be granted by the relevant state authorities and require that the applicant is trustworthy and is in proper financial circumstances. In the unlikely event that the Fintech company is also involved in the processing of payments between lenders and borrowers or credit institutions and borrowers, the licence requirements of the German Payment Service Act apply.

However, depending on the contractual arrangements, the activities of the users of a lending platform may qualify as banking business regulated by the German Banking Act. The granting of loans via a lending platform may qualify as granting loans, which is a regulated activity under the German Banking Act, and the acceptance of such loans may qualify as deposit-taking business, also a regulated activity under the German Banking Act.

To avoid such licence requirements, most lending platforms co-operate with an established and licensed credit institution that issues the loan to the borrower and sells the loan receivables to the users of the lending platform, who gave a binding commitment to buy the loan upfront. In such an arrangement, neither the users of the platform that act as 'lenders' nor the borrowers will conduct a regulated activity under the German Banking Act.

Crowd Investing

The operation of a crowd investing platform by a Fintech company may qualify as investment broking or contract broking in the meaning of the German Banking Act if financial instruments are traded on the platform. Both activities require licences under the German Banking Act.

Investment broking includes the transmission of the offer of the investor as its agent to buy or sell financial instruments from or to the other party in the transaction. Such transmission can also be carried out electronically; anyone who operates an IT system that transmits such offers to potential counterparties is providing investment broking. This also applies to operators of crowd investing platforms.

If the platform operator acts not only as agent but also as authorised representative, this may constitute contract broking. The platform operator will qualify as an authorised representative if it is authorised to accept the investor's offer by the company.

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Furthermore, the operator of a platform may conduct deposit business if the platform allows investors to pay its funds (which they like to invest) to the platform before the relevant investment agreements have been concluded.

As mentioned before, the qualification of the operation of a crowd investing platform as investment broking or contract broking requires that financial instruments in the meaning of the German Banking Act are traded on the platform. Financial instruments include securities (in particular shares and bonds), derivatives and investment products (*Vermögensanlagen*) in the meaning of the German Investment Product Act (*Vermögensanlagengesetz*, or *VermAnlG*). Such investment products include interests that involve a participation in the performance of the company (like interests in a limited liability company or a limited liability partnership), participants in trust assets, profit participating loans, subordinated loans, profit participating rights, registered bonds and other investments that promise interests and a repayment of the invested funds as compensation for the temporary use of the funds.

In addition, the licence requirements under the German Payment Services Supervision Act may be applicable if the crowdfunding platform operator accepts funds from investors and passes them on to the offeror of the investment.

The licence application under the German Banking Act for investment broking or contract broking will also have to include a description of the intended business model; a business plan; a description of the internal control systems, including a risk management system and how the platform operator ensures compliance with the applicable laws; a description of the organisational set-up of the Fintech company; and information about the managing directors, the holders of major participations (10% or more of the capital or voting rights) in the Fintech company and the Fintech company itself. Furthermore, the application will have to include evidence that the Fintech company has sufficient funds to run its business.

The Fintech company will need to have one managing director, who has to be trustworthy and sufficiently qualified. To be sufficiently qualified, managing directors must have adequate theoretical and practical knowledge of the business concerned as well as managerial experience. The theoretical and practical knowledge has to be proved by the education and prior professional activities of the relevant managing director. In general, a person is deemed to have the necessary professional qualification if he/she can prove three years of managerial experience in a financial services company or credit institution at top management level or one level below top management level.

Pursuant to the German Securities Trading Act (*Wertpapierhandelsgesetz*, or *WpHG*), the operator of the crowd investing platform is obliged to request from the investors information about their financial knowledge and experience to assess the suitability of the relevant financial instruments distributed on the platform for the relevant investor. The operator of the platform has to notify the investor about the fact that the relevant financial instruments are not suitable for the investor if it comes to such a conclusion. This exploration duty does not apply in the case of non-complex financial instruments (like shares traded on an exchange) in execution-only business. Furthermore, pursuant to the German Securities Trading Act, the platform operator has to provide the user of the platform with information about itself and the offered investment services before providing such services.

The public offer of the financial instruments on the crowd investing platform may require the publication of a prospectus pursuant to the German Securities Prospectus Act (*Wertpapierprospektgesetz*, or *WpPG*) or the German Investment Product Act. There are certain exemptions with regard to the prospectus publication duty depending on the minimum subscription amount, the volume of the offering and the qualification of the investors. Furthermore, the Investment Product Act includes one exemption specific for crowd investing platforms. Such offerings are exempted from the prospectus publication duty if the volume of the offering does not exceed EUR2.5 million and is distributed only via an internet platform that is obliged to restrict the maximum investment of each investor to defined thresholds with regard to the offering.

Blockchain

There is no specific regulatory regime for financial activities in connection with blockchains, but BaFin qualifies Bitcoins and other virtual currencies as units of account (*Rechnungseinheiten*) and therefore as financial instruments under the German Banking Act. Virtual currencies do not qualify as e-money as they are not issued by one issuer that will take them back in exchange for money.

The use of virtual currencies and the holding of virtual currencies for third parties do not qualify as regulated activities under the German Banking Act. Virtual currencies do not qualify as money and therefore the holding of them for third parties does not qualify as deposit-taking business. With regard to safekeeping of financial instruments, only the safekeeping of securities is a regulated activity under the German Banking Act.

In principle, the mining of virtual currencies is not a regulated activity, but based on the qualification of virtual currencies as units of account, the operation of a trading platform for virtual currencies may qualify as a regulated activity.

Based on the structure of the platform, the operator could conduct banking business in the form of principal broking or provide financial services in the form of investment broking, operation of a multilateral trading facility or contract broking.

Fintech companies that exchange virtual currencies in fiat money as a service for others provide financial services in the form of trading for own account. Furthermore, BaFin has stated that commercial mining pools that offer shares of the mined virtual currencies to users in exchange for computer power generally also provide financial services, without specifying as to what kind of financial service this activity should qualify as.

Fintech companies operating in the blockchain sector that want to apply for a licence have to fulfil the same requirements for a licence as mentioned above and as financial service providers that are not operating in the blockchain sector.

Trading and Investments

Robo Advice/Automated Portfolio Management

The Fintech companies offering robo advice or automated portfolio management to their clients in general provide financial services in the form of investment advice or portfolio management. In addition, and depending on the set-up, they could provide investment broking or contract broking. All these activities require a licence pursuant to the German Banking Act. The requirements for the application of the licence are the same as the ones set out before.

If the Fintech company only provides advice with regard to general asset allocation without providing advice about specific financial instruments, such activities will not qualify as investment advice as this requires advice about a specific financial instrument. Fintech companies that offer their users the service to copy automatically all trades of other users of the platform may provide financial services in the form of portfolio management. If the Fintech companies automatically issue the orders for the users that follow other traders, BaFin will qualify this activity as portfolio management by the Fintech company as it assigns the trading decisions of the user that the other users follow to the Fintech company. If the user decides for each individual trade if it wants to copy that trade for its own account or not, the Fintech company will not provide investment advice or portfolio management but probably investment broking if it forwards the order of the user to a broker.

Fintech companies providing investment advice, portfolio management, investment broking or contract broking will also have to follow the rules of conduct laid down in Part 6 of the German Securities Trading Act, including that the Fintech company has to provide the user of the platform

with information about the company and the offered investment services before providing such services. Furthermore, the Fintech company is obliged to request from its users information about their financial knowledge and experience, their financial background and their investment objective, which are required to provide suitable advice for the user. In the case of investment advice, the Fintech company has to prepare investment advice minutes and has to report to BaFin all its employees that provide investment advice to its clients. In the case of robo advice, the persons responsible for the advice have to be reported to BaFin as investment advisers.

2.2 Regulatory or Governmental Agencies for Specified Activities or Fintech Companies

The competent supervisory authority for the authorisation and supervision of Fintech companies is BaFin. In general, its supervision of Fintech companies is comparable to the supervision of other financial service providers. BaFin has rights of information and inspection as well as sanctions for not complying with official orders or requirements, and visits the supervised companies on a regular basis but not more than once a year. Generally, relevant laws are enforced by BaFin, which is subject to legal and professional supervision by the Federal Ministry of Finance. The level of supervision is generally the same if the Fintech companies target professional investors or retail investors but BaFin seems to put the focus of its supervision on aspects of consumer protection so that the supervision of Fintech companies targeting retail investors may become stricter.

2.3 Capital and Liquidity Requirements

The initial capital requirements for Fintech companies applying for a licence under the Payment Service Supervision Act depend on the payment service they are applying for. In the case of a money remittance business, an initial capital of EUR20,000 is required. For the provision of digital payment services, the required initial capital is EUR50,000 and for other payment services, EUR125,000. Fintech companies applying for a licence for e-money business require an initial capital of EUR350,000.

Furthermore, Fintech companies in the payment sector will have to have ongoing sufficient funds to run their business. This capital requirement is specified by the Payment Institutions' Capital Regulation (*Zahlungsinstitut-Eigenkapitalverordnung*) and is calculated based on the payment volume processed by the payment service provider and the payment service it is providing. In specific cases the sufficient capital requirements will be calculated on the basis of the costs or the earnings of the relevant payment service provider. Payment service institutions that issue e-money are required to hold as a minimum of own funds 2 per cent of the issued e-money.

Fintech companies licensed under the German Banking Act have to comply with several initial capital requirements. Fintech companies require an initial capital of EUR50,000 if they do not trade on their own account and are not authorised to obtain ownership or possession of funds or securities of its customers and provide as financial services investment advice, investment broking, contract broking, portfolio management, placement business or the operation of a multilateral trading facility. Fintech companies that do not trade in financial instruments for their own account but do not fall into the aforementioned categories must have an initial capital of at least EUR125,000. Fintech companies that trade in financial instruments for their own account or qualify as securities trading banks must have an initial capital of at least EUR730,000. The initial capital must be freely available and may not be derived from borrowing. If a Fintech company is applying for a licence as a deposit-taking credit institution, an initial capital of EUR5,000,000 is required. Fintech companies that provide only deposit broking, foreign currency dealing, factoring or financial leasing are not subject to any initial capital requirements. Fintech companies providing portfolio management or contract broking must have, at all times, own funds of at least one quarter of the fixed overhead costs incurred in the preceding year.

2.4 “Sandbox” or Other Regulatory “Neutral Zones”

At the moment there is no 'sandbox' or other regulatory 'neutral zones' established by BaFin or the government. Furthermore, BaFin has indicated that it has no intention to offer a sandbox for Fintech companies.

2.5 Change of Control Approval Requirements

Any person who intends to acquire a qualified participating interest in a company licensed under the German Banking Act (ie, directly or indirectly holding at least 10% of the share capital or voting rights) has to inform BaFin and Deutsche Bundesbank about the intention and conduct a holder control procedure. As part of the holder control procedure, the potential acquirer has to file information required for assessing the trustworthiness of the legal representatives (fit and proper forms) of the acquirer and corporate information about the acquirer, including certificate of incorporation, certificate of good standing (if available), current articles of association, annual reports for the last three years, description of the business activities, information about the group structure accompanied by a group chart and reliability statements.

BaFin uses the submitted documents and declarations to assess whether the proposed acquirer meets the legal requirements regarding reputation and financial soundness, and has 60 working days for the assessment. If the acquisition of the qualifying holding is not prohibited in writing within the assessment period by BaFin, it can be carried out.

2.6 Recent Developments or Notable Proposed/ Forthcoming Regulatory Changes

For Fintech companies active in the payment sector, the upcoming progression of Payment Service Directive II (PSD II) into national law will be of relevance. The national regulations will come into effect in January 2018. PSD II regulates two new payment services: payment initiation and account information. In particular, some of the Fintech companies that collaborate with existing payment service providers without qualifying as a payment service provider themselves provide payment initiation services or account information services to their users. Such Fintech companies will become subject to the regulation of the ZAG and will require a licence after a grace period.

Fintech companies active in the trading and investment sector will have to comply with the new regulations of Markets in Financial Instruments Directive II (MiFID II) that will also come into force in January 2018. If not started by now, such Fintech companies should assess how MiFID II will impact their business.

Furthermore, BaFin released in April 2017 an updated circular with regard to anti-money laundering (AML) video identification. In the first draft of an updated circular for the video identification procedure, BaFin restricted the use of video identification to credit institutions and would have excluded most of the Fintech companies from the use of video identification as part of the AML identification of their customers. The new updated circular allows the use of video identification for all obligated persons under the German Anti Money Laundering Act. The new circular sets out further requirements for the identification process and was applicable from June 2017.

2.7 Burden of Regulatory Framework and Protection of Customers

The regulatory framework for Fintech companies is the same as for other financial institutions governed by the ZAG or KWG. The German regulatory framework provides a sufficient level of customer protection but still leaves flexibility for Fintech companies to pursue their business case. This same 'level playing field' approach comes with some burden for Fintech companies but may help them to attract users and customers for their products and does not allow established players in the financial area to depreciate Fintech companies because of their lower level of regulation.

2.8 Regulatory Impediments to Fintech Innovation at Traditional Financial Institutions

There are no special regulatory impediments to Fintech innovations at traditional financial institutions like banks and insurance companies. For 'level playing field' and consumer protection reasons, Fintechs have to comply with the same requirements as traditional institutions.

2.9 Regulatory Regime's Approach to Consumers and Small Business Customers

As a general rule, if consumers are involved in a business model then German regulations tend to be more strict and aim to protect consumers. Regulations have been increased in this regard and the supervision powers of BaFin enhanced. In particular, BaFin could now ban certain products if it regards them as potentially dangerous for consumers.

2.10 Outreach by Regulators or Government Authorities to Engage with Fintech Innovators

The German Federal Ministry of Finance has invented several initiatives to facilitate Fintech development and regulation, including FinCamp, a series of events aimed at promoting dialogue with German financial technology companies and the establishment of a 'Fintech-Rat', which is a group of 20 experts that is supposed to support the development of Fintechs and their legal circumstances.

Furthermore, BaFin has established an internal working group for Fintech regulation, which consists of experts from different working areas of BaFin. According to BaFin, the objective of the working group is to observe the latest developments in the Fintech market and to review whether BaFin needs to adjust its processes in view of new developments in the area of digitalisation. BaFin has already organised a workshop in 2016 for Fintech companies called BaFin-Tech, where BaFin explained its view on the regulation of typical services provided by Fintech companies. BaFin plans to organise further workshops on Fintech issues.

2.11 Unregulated Specified Activities

As far as specified activities not covered by the regulatory framework, they are mentioned in **2.1 Regulated Regimes For Specified Activities of Fintech Companies**, but, as a general rule, the scope of the regulatory framework is quite broad.

2.12 Foreign Fintech Companies

In principle, foreign Fintech companies face the same regulation as domestic Fintech companies. However, Fintech companies with their home member state in another jurisdiction might benefit from the EU passporting system allowing them also to offer their services in Germany under the licence granted in another EU member state after notification of BaFin. This is an easy way to offer products and services in several EU states and is applicable for German Fintech companies operating in other EU states as well.

Foreign Fintech companies should be aware of BaFin's view that financial services provided on a cross-border basis into Germany are performed in Germany and therefore trigger the licence requirement under the German Banking Act if the Fintech company is intentionally approaching the German market, which also applies if the Fintech company has

no physical presence, such as offices or branches, in Germany.

2.13 Regulatory Enforcement Actions Against Fintech Companies

In the absence of any indications or publications of the German Federal Ministry of Finance or BaFin, it is assumed that there have not been many regulatory enforcement actions against Fintech companies in Germany recently.

2.14 "Shadow Banking"

Germany has regulations intended to limit 'shadow banking'. BaFin published a circular letter regarding a limitation of shadow banking businesses that are not part of the regulated banking sector on 2 December 2016, which has been valid since the beginning of 2017. The circular serves as an implementation of the Guidelines – Limits on Exposures to Shadow Banking Entities Which Carry Out Banking Activities Outside a Regulated Framework Under Article 395(2) of Regulation (EU) No 575/2013 published by the European Banking Authority (EBA) on 3 June 2016. German regulation is based on European law and therefore applies in other member states of the EU as well.

Whether Fintech companies are captured by these regulations depends on the business model of the company. A shadow bank in the meaning of the guidelines is a business offering and executing credit intermediation such as liquidity or maturity transformation, leverage or something similar. If Fintech companies perform these services, they will be captured by the regulation as well.

3. Form of Legal Entity

3.1 Potential Forms of Charter

In general, there are different kinds of legal entities in Germany. The primary potential forms of charter that may be used by Fintech companies are a limited liability company (GmbH) or a joint-stock company (AG):

A limited liability company is a legal entity in its own right. The required capital of a GmbH must total a minimum of EUR25,000 at the time of the establishment of the company due to liability reasons and the original capital contribution of each partner must be at least EUR1.

The contributions of partners are allowed to be made in kind, in which case the items used to make the contribution together with their estimated values must be stated in the partnership contract. The assessed value of such contributions must be stated in a special report concerning the company's foundation on the basis of non-cash contributions.

Legal entities, regardless of whether they are licensed under German or foreign law, may also be members of a GmbH.

Foreign legal entities may be recognised in the Federal Republic of Germany if they are based in their native country and if their recognition would not offend common practices or be in violation of German law. The recognition of foreign legal entities and other trade associations is usually ensured by international treaties and agreements.

The GmbH is judicially and non-judicially represented by its managing director(s) (*Geschäftsführer*), who need not reside in the Federal Republic and may, though they are not required to, be partners of the company. The directors are to be appointed and dismissed at the corporation meeting of the partners and are to be listed in the Commercial Register.

All business correspondences and letterheads must contain certain information about the company, including the firm (name of the company), the legal form of the company, the location and court of registration, its registration number in the Commercial Register and the first and surname(s) of the managing director(s).

A joint-stock company is a legal entity in its own right. The minimum capital, EUR50,000, consists of par-value shares with a minimum value of EUR1 per share or of non-par value shares.

An AG can be founded by an individual. All individuals, including legal entities, may be members of an AG. It is to be judicially and non-judicially represented by the management board, which may consist of one or more persons appointed by the supervisory board, which must consist of at least three members. For larger joint-stock companies, other regulations determine the minimum number comprising the supervisory board. The main duty of the supervisory board is to supervise the business management of the manager or management board. Like the business correspondences and letterhead of a GmbH, those of an AG must contain certain information: the firm, the legal form of the company, the location and court of registration, its registration number in the Commercial Register, the first and surname(s) of all members of the management board and the first and surname of the chairman of the supervisory board.

Information regarding the establishment and costs associated with the establishment can be obtained from the Chamber of Industry and Commerce.

So far, a significant number of Fintech companies do not require authorisation from BaFin, because the Fintech companies co-operate with banks, insurance companies or other financial institutions operating under the licence of this financial institution or limiting the Fintech's operation to

non-regulated parts. As an example, Germany's largest bank, Deutsche Bank, has announced three strategic partnerships with domestic Fintechs. In the near future, Deutsche Bank's customers will be offered robo advisory services (in co-operation with Fincite), multi-account aggregation (partnering with Figo) and European short-term deposits as an investment opportunity through the Deposit Solutions platform.

If the Fintech company does not co-operate with another financial institution, it is subject to the same obligations as the established institutions and therefore could require an authorisation by BaFin as well.

However, whether or not such an authorisation is required for the activities or whether they are subject to trade supervision is not always clear at first glance. Business models that appear to be similar can differ from each other when examined more closely and this has a direct impact on the duties that the undertakings need to comply with. At the same time, issues may arise regarding collective consumer protection and BaFin follows up on these as part of its new mandate based on Section 4 (1a) of the Act Establishing the Federal Financial Supervisory Authority (*Finanzdienstleistungsaufsichtsgesetz*, or FinDAG).

3.2 Key Differences in Form

The main advantage of using a corporation as a legal organisation (GmbH or AG) is the limitation of liability to the assets of the company, although the company must demonstrate that it is endowed with a minimum or initial capital, which will depend on the nature of its intended business. For securities-trading banks, for example, the initial capital required is at least EUR730,000, while for deposit-taking credit institutions, it is at least EUR5 million. Nevertheless, the liable capital remains restricted to this amount.

In order to found a Fintech company that intends to offer services requiring authorisation by BaFin, it is preferable to co-operate with an established financial institution. If this institution assumes the subject of business that is the subject of approval by BaFin, the Fintech company will not need a further authorisation and can start its intended business right away (as long as this business does not need an authorisation as well).

4. Legal Infrastructure (Non-regulatory)

4.1 Desirable Changes to Facilitate Specified Activities

Changes in IP protection may occur in relation to the upcoming implementation of European Directive 2016/943. See 6.2 Trade Secret Regime.

4.2 Access to Real Time Gross Settlement Systems

Securities supplement systems and cash settlement systems can only be accessed through financial institutions or banks.

4.3 Special Insolvency Regimes

There are no special insolvency regimes or other regimes that apply differently to Fintech companies as compared to regulated financial institutions. Every business offering financial services is treated the same in Germany with regard to insolvency because of the German Insolvency Act (*Insolvenzordnung*, or InsO). If the entity is a financial institution or a bank, additional special provisions under the German Banking Act (KWG) apply.

4.4 Electronic Signatures

Electronic signatures are generally not treated as equivalent to normal signatures in Germany, but if the electronic signature applies to the German Act on Digital Signature (*Signaturgesetz*, or SigG), it could be put on the same level.

Whether an electronic signature is considered equivalent to a handwritten signature (ie, a qualified electronic signature) depends on the quality of the certification service (qualified certificate) and the security level. There are three different electronic signatures governed by differing requirements: simple, advanced and qualified. Only the qualified electronic signature is equivalent to a typical handwritten signature. It allows a long-term verifiability of the authorship. The Federal Network Agency of Germany (*Bundesnetzagentur*) is the competent authority responsible for the SigG.

In order to create a qualified electronic signature, a qualified certificate is needed, which is given by the Federal Network Agency.

4.5 Standards for Proving Identity in Electronic Transactions

Germany does not have any standards for proving identity in electronic transactions.

5. Data Privacy and Cybersecurity

5.1 Data Privacy and Cybersecurity Regulatory Regimes

Germany's cybersecurity law basically refers to the national Act to Increase the Security of Information Technology Systems (IT Security Law), which was published on 24 July 2015. The IT Security Law aimed to improve the level of IT security of certain companies and protect citizens online. In contrast to the prior regulatory regime, the IT Security Law now includes the possibility of administrative fines (of up to EUR100,000 in the case of a serious violation).

As of 25 May 2018, the data protection landscape in the EU will be regulated consistently because of the validity of the General Data Protection Regulation (*Datenschutzverordnung*, or GDPR), which will replace the current Directive and will be applicable in all member states without the need for implementing national legislation. The biggest change to the regulatory regime will probably be the extended jurisdiction of the GDPR, as it applies to all companies processing the personal data of data subjects residing in the Union. In addition, organisations in breach of the GDPR can be fined up to 4% of annual global turnover or EUR20 million, whichever is greater. This raises the possible penalty considerably.

5.2 Recent and Significant Data Privacy Breaches

In the absence of any public indications regarding such breaches or cybersecurity attacks, it is assumed that there have not been any recent and significant data privacy breaches or other cybersecurity attacks involving Fintech companies.

5.3 Companies Utilizing Public Key Infrastructures or Other Encryption Systems

There are relevant laws specific to companies utilising public key infrastructure or other encryption systems to create or manage digital certificates using digital signatures: the German Act on Digital Signature, amended by the Signature Act (*Signaturverordnung*, or SigV).

5.4 Biometric Data

There are no special regulatory regimes specifically applicable to biometric data. The Data Protection Act (*Datenschutzgesetz*, or BDSG) is probably the most important principle, adaptable to biometric data because of all the personal information of German citizens in connection with such data.

Nevertheless, there are federal associations like TeleTrusT, which is the federal association for IT Security, that are making an effort to develop special regulatory regimes regarding biometrics.

6. Intellectual Property

6.1 Intellectual Property Protection Regime

Germany has a strong regime to protect IP rights and has been a member of the World Intellectual Property Organization (WIPO) since 1970.

Germany is also a party to the major international IP protection agreements: the Bern Convention for the Protection of Literary and Artistic Works, the Paris Convention for the Protection of Industrial Property, the Universal Copyright Convention, the Geneva Phonograms Convention, the Pat-

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ent Cooperation Treaty, the Brussels Satellite Convention and the Treaty of Rome on Neighbouring Rights. Many of the latest developments in German IP law were derived from European legislation with the objective of making applications less burdensome and to allow for European IP protection.

The protection and enforcement of IP rights and other rights relevant to Fintech in Germany is governed by a wide range of EU and national laws that overlap and complement one another.

Apart from the fact that Germany is part of the EU trademark system and the EC design system, which means that European Trade Mark Regulation 2015/2424 and European Design Regulation 6/2002 directly apply and provide for the protection of EU trademarks and (registered and non-registered) Community designs in the territory of Germany, protection is provided in particular by the following national laws that implement European directives and international IP protection treaties:

- the Trade Mark Act (*Markengesetz*, or *MarkenG*);
- the Design Act (*Designgesetz*, or *DesignG*);
- the Patent Act (*Patentgesetz*, or *PatG*);
- the Act on Utility Models (*Gebrauchsmustergesetz*, or *GebrMG*);
- the Act on Copyright and Related Rights (*Gesetz über das Urheberrecht und verwandte Schutzrechte*, or *UrhG*); and
- the German Act Against Unfair Competition (*Gesetz gegen den unlauteren Wettbewerb*, or *UWG*).

6.2 Trade Secret Regime

Trade or industrial secrets are protected under several statutory provisions in Germany, with Sections 17-19 UWG containing the core set of rules focusing on the protection of trade or industrial secrets disclosed to employees, industrial espionage and the unlawful exploitation of trade and industrial secrets. Apart from some specific provisions – as are contained, for example, in the German Criminal Code (*Strafgesetzbuch*) and the German Fiscal Code (*Abgabenordnung*) – additional protection is provided by the German Civil Code (*Bürgerliches Gesetzbuch*, or *BGB*), in particular Sections 311, 241(2) BGB (if confidential information is shared in negotiations), Section 242 BGB (performance in good faith) and Sections 823 BGB et seq (tort law).

The regime of protection is still fragmentary, though. Given that Sections 17-19 UWG are criminal law provisions, their very specific conditions have to be interpreted narrowly and in some cases it may be difficult to furnish proof that the person using the trade or business secret acted intentionally. Furthermore, German law does not set out a statutory definition of 'trade secret' or 'industrial secret'. According to the prevailing case law of German courts, trade secrets fall

within the scope of Section 17 UWG if they comprise technical and non-technical business information concerning a certain business, which is not generally known or readily ascertainable but only known by a restricted number of persons and that is kept confidential. Against this background, companies are well advised to use contracts to ensure that disclosed information is expressly designated as 'confidential'.

Changes in the regime of protection may occur in relation to the upcoming implementation of European Directive 2016/943 on the Protection of Undisclosed Know-how and Business Information (Trade Secrets) against their Unlawful Acquisition, Use and Disclosure by the German legislator that has to take place until 9 June 2018.

6.3 Copyrights, Patents, Trade Marks

For Fintech and all intellectual accomplishments involved therein, the same conditions of IP protection apply as in other fields.

Software may be the subject of copyright protection. Where a computer program is created by an employee in the execution of his or her duties or following the instructions of his employer, according to Section 69b UrhG, the employer shall be entitled to exercise all economic rights in the computer program, unless otherwise agreed. The same applies for service relationships. Nevertheless, it is advisable to include a provision in an employment or service contract that ensures that all IP rights that may come into existence shall belong to the company.

Depending on the circumstances of the individual case, financial technology may also be eligible for protection by a patent or utility model. The outer appearance of a product may be subject to protection by registered or unregistered design rights, copyright, under unfair competition law or even trademark law. Signs used in order to indicate the commercial origin of a product may be registered as trademarks.

6.4 Protection of Intellectual Property or Trade Secrets

In addition to, or instead of, making use of the various means of legal protection German law provides, Fintechs may want to rely on factual ways of IP protection such as keeping specific know-how secret, building high-trust relationships with customers and suppliers or using lead-time advantages. In general, it is always a question of a Fintech's overall business strategy whether and which kind of IP rights shall be registered or not. This applies in particular with respect to innovative technologies that a company may prefer to keep confidential and thus refrain from applying for registration as a patent or utility model in order to avoid competitors gaining insight into business-relevant information from the register. Furthermore, the costs for applying and defending

IP rights may have a considerable impact on a Fintech's decision to apply for registered IP rights. On the other hand, registered IP rights represent valuable corporate assets that may play an important role in negotiations with investors.

6.5 Joint Development of Intellectual Property

Apart from situations where the employer company acquires the right to exercise the rights in a software solution (Section 68b UrhG) or the right in a design (Section 7(2) DesignG, Article 14(2) European Design Regulation 6/2002) created as the result of teamwork anyway, joint ownership of IP may arise when the subject of protection has been developed jointly by two or more partners.

Co-owners of IP rights may have different rights in the jointly owned results of their work at their disposal (for example, shares, rights of use, rights of exploitation, in particular by assignment and/or licences, management rights), depending on the type of IP right and the circumstances under which the protected results were jointly developed in the individual case.

Given that many legal details in this respect are disputed and that co-ownerships may become a considerable source of conflict, it is highly recommendable to address all relevant issues in a co-ownership agreement.

6.6 Intellectual Property Litigation

Given that IP is often one of the most important, if not the most important, business asset of a Fintech company, it is, in general, a significant source of litigation in Germany. Fintech start-ups particularly tend to fear the relatively high costs involved in defending their IP rights in litigation, in particular a patent litigation, so will often prefer to resolve conflicts with competitors amicably. However, compared to other jurisdictions, litigation in Germany is considered as relatively affordable, which is another incentive to file for IP rights in Germany or the EU, where enforcement costs are reasonable.

6.7 Open Source Code

Open-source software is protected by copyright (Sections 69a, 2(1) No 1 UrhG) and may only be used if the conditions of a licence granted by the owner of such copyright are met. The so-called General Public Licence is very popular amongst developers and companies, and its licence conditions have been successfully enforced before German courts in several decisions. In order to avoid legal risks – in particular being confronted with claims for cease and desist, and damages based on copyright infringement – Fintech companies using open-source software should make sure that all obligations following from the respective licence are fulfilled. By the so-called copyleft effect of some open-source licences, the use of open-source code may 'infect' the user's proprietary software and may cause the loss of rights therein.

Further, the risk of patent infringements has to be considered, as some open-source programs may rely on patent-protected technologies.

There are various ways to identify issues with open source, even if no source code is at hand. In any case, a Fintech company dealing with open-source software should establish a set of simple and effective compliance rules for an open-source licence management that keeps risks at bay.

7. Tax Matters

7.1 Special Tax Issues, Benefits or Detriments

There are no special tax issues or detriments to Fintech companies or the specified activities. As mentioned above, the primary potential forms of charter that may be used by Fintech companies are a limited liability company or a joint-stock company. In Germany the taxation is based on the form of the Fintech.

Recently, there has been a reform of the tax rules for carrying forward losses, which will make it easier for companies with innovative business models to grow. The aim is to eliminate tax obstacles that prevent businesses from gaining access to capital when new shareholders are introduced or existing ones are replaced. Before the tax reform, companies that needed to find new shareholders or to replace existing ones to raise sufficient capital were forced to forfeit unused losses. The new rules take account of this situation. Therefore, the German government created a special benefit regarding start-ups.

8. Issues Specific to the Specified Activities

8.1 Additional Legal Issues

Fintech companies active in the blockchain sector may consider an initial coin offering or token sale as a way of financing. There has seemingly been no regulatory statement with regard to the qualification of such token sales in Germany and the regulation that applies to a token sale depends on the structure of the token.

Any sale of tokens that give the token holder a right to participate on revenues or earnings of the company issuing the token (equity tokens) or that give the token holder a right to receive interests from the company issuing the tokens or are redeemable to the company (debt tokens) are likely to qualify as an offer of at least an investment product under the Investment Product Act (see crowd investing above). Such tokens also qualify as financial instruments, so that any investment advice or broking of such tokens would qualify as investment advice or investment broking under the Ger-

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man Banking Act and requires a licence. Tokens that give the token holder access to a system or the right to contribute or to use a system or its outputs (network tokens or usage tokens) are likely not to qualify as investment products. Furthermore, there are good arguments that these tokens do

not qualify as units of accounts like virtual currencies and therefore also not as financial instruments. Any investment advice or broking of such tokens would therefore not qualify as investment advice or investment broking under the meaning of the German Banking Act.

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 **HEUKING KÜHN LÜER WOJTEK**

Doing Business in Germany

Country Profile

Germany is Europe's largest economy and derives strength from its position as a leading manufacturer and exporter. The country plays a key role in European unity and is a major proponent of integration.

Sources note that the transactional market is stabilising and enjoying an increasing level of activity, although there is still an element of "volatility." In the second quarter of 2017, GDP grew by 2.1%.

Business Culture

Businesses looking to come to Germany need to "make sure they get good advice and play by the rules." It is advisable to "take time to understand what it means to do business here and talk to as many people on the ground as possible."

Businesspeople assert that although language skills are "rarely an issue," because the business community usually speaks English, it pays to be sensitive. Experts warn that "much depends on your counterparty, because while some Germans do not feel comfortable speaking English, others may be offended that you think they cannot speak English." It is advisable to have the assistance of someone fluent in German.

Legal Market

Germany has a well-established legal market, and interviewees state that "even the smallest firms that deal with transactions will have a specialist." There is a strong local market with a robust international presence. Many clients find that "even the independent firms have some form of working relationship with many of the major international brands."

Sources report that there are three types of firm on the market: international, national and those which are active in just one city or local market. It has been suggested that the local firms are "usually the ones with the best guess as to what the local courts are like in terms of litigation."

Lawyers in Hamburg tend to be particularly experienced in anti-competition matters, due to the volume of cases and the expertise of the judges in the Hamburg courts. Similarly, certain law firms in Berlin have beneficial relationships with lawmakers and regulators. This can be helpful to businesses as these firms can "provide insights into what is going to happen further down the line."

Notaries are a notable feature of the market. Certain documents, including contracts, need to be notarised under German law – making notaries an important part of projects.

Regulatory System

It is generally accepted that "the regulatory rules are cast in iron, but you get speedy results," especially if you have the assistance of an experienced lawyer. Businesspeople consider the German system to be highly supervised but "the rules and regulations are transparent and there is helpful published guidance."

Experts affirm that "it is easy to get in touch with the relevant people and find out what is happening with the case." It is possible to bring up timing concerns with the officials, but it is generally accepted that "the authorities are quick. They usually respond, reply and decide comfortably within the given timeframe, if not before."

Fees and Billing Methods

Market experts have observed some pricing pressure in the German market, but it is "not as pronounced here as it is in other areas of Europe." Such reductions are partly due to "there being more lawyers than business in the current market."

Sources note that discounts are available following negotiations. "Prices can drop 15–20% after discussions," explains one businessperson. "They may also be agreed on if a company does repeat business with a law firm." A source cites "fee volume and the status of a company" as other factors in discounts.

Such discounts are from the firm's headline hourly rates. These vary between practice areas and firms. International firms are, generally, more expensive than their domestic counterparts. For example, a partner practising M&A at an international office will cost a client between EUR500 and EUR600 an hour, while an equivalent lawyer at a domestic player will cost between EUR300 and EUR500.

Alternative methods of billing are becoming increasingly common. One source agrees that "this is a development which is becoming stronger. For complex transactions, we like to have a budget set as a benchmark, or the fees broken down into different caps. The clients really want to accompany the lawyers through transactions."