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Client Letter

Capital Markets Update

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Speed Read:

1. **Change of German prospectus publication and corporate disclosure rules:**
   - Obligation to publish a notice on the availability of the prospectus has been deleted
   - Corporate information needs to be additionally published in recognized newspapers until 2010

2. **Determination of the Home Member State by non-EU issuers:**
   - Regulatory proposal may require non-EU issuers to comply with German transparency regime

3. **Review of the Prospectus Directive:**
   - European Commission proposes only few specific amendments to Prospectus Directive
   - Comments on a relaxed disclosure regime for small quoted companies and an exemption for rights issues are requested

4. **BaFin consults draft of revised Issuer Guidelines *(Emittentenleitfaden)***

5. **New banking license requirement for collective portfolio management *(Anlageverwaltung)*:**
   - Applicability on funds in a corporate structure is still unclear

6. **BaFin circular on scope of German Investment Act**

7. **Government presents draft bill on the law of bonds**
   - Proposal facilitates majority votes and modernizes rules governing creditors' meetings

1. Change of German prospectus publication and corporate disclosure rules

(a) Prospectus publication

Until the end of 2008 the general publication regime governing the publication of securities prospectuses in Germany required not only the publication of the prospectus via certain media or certain intermediaries. In addition, the offeror or person applying for admission to listing was required to publish a notice in newspapers widely circulated in the EU Member States which notice had to state in what manner the prospectus was published and where it can be obtained. The same additional requirement applied to the publication of any prospectus supplement and the final terms of the offer in case a base prospectus had been issued.

The German Annual Taxation Act 2009 *(Jahressteuergesetz 2009)* eliminated the aforesaid obligation to publish a notice on the availability of the prospectus, its supplements and any final terms by deleting section 14(3) sentence 2 of the German Securities Prospectus Act *(Wertpapierprospektgesetz – WpPG)*. The German Annual Taxation Act 2009 has taken effect on 24 December 2008 (BGBl. I No. 63 of 24 December 2008 p. 2794).

It should be noted, though, that the obligation to notify the German Federal Financial Supervisory Authority *(Bundesanstalt für Finanzdienstleistungsaufsicht – BaFin)* of the place and date of the publication of the prospectus has not been deleted at the same time and still requires attention within any public offering in Germany. Such written notification to BaFin is required irrespective whether the prospectus has been approved in Germany or passported to Germany under the EU Prospectus Directive.

(b) Disclosure of corporate information

The German Securities Trading Act (*Wertpapierhandelsgesetz – WpHG*) provided for an interim period

terminating at the end of 2008 in which certain corporate information was not only to be published by listed companies in the German electronic Federal Gazette (*elektronischer Bundesanzeiger*), but in parallel to be published in additional newspapers recognized by the respective stock exchange for such purpose. Simultaneously with the deletion of the aforesaid prospectus notification requirement, the German Annual Taxation Act 2009 extended the interim period in which such corporate information needs to be published in recognized newspapers until the end of 2010.

Useful link:

German Annual Taxation Act 2009 *(Jahressteuergesetz 2009):*
http://frei.bundesgesetzblatt.de/index.php?teil=I&jahr=2008&nr=63

2. Determination of the Home Member State by non-EU issuers

Within the European Union (EU) a harmonized disclosure regime for public companies was created in 2007 and 2008. The idea was to have the same disclosure and reporting requirements throughout the EU but only one national authority supervising compliance with such harmonized rules. Therefore, every issuer is allocated to one EU jurisdiction (its Home Member State) and only the regulator of the issuer's Home Member State has power to oversee compliance with the national rules (which in principle should be the same in all EU Member States). The Home Member State of non-EU issuers is generally determined along the lines of where securities of such issuer are listed or where it conducted a public offer for the first time.

Unfortunately, the German legislator created a deficient system in determining the Home Member State of non-EU issuers, which were listed in Germany prior to 2003 and have neither offered securities publicly since 2003 nor explicitly exercised their right of choice with respect to their Home Member State. Therefore, as of today BaFin does not enforce the German reporting rules against issuers listed in Germany, with respect to which the Home Member State cannot be reliably determined.

Recently BaFin proposed to the German Ministry of Finance to close the existing loophole by requiring the issuers with respect to which the said uncertainty exists to exercise their right of choice.

If implemented, such requirement will force many non-EU issuers, which are not listed on any stock exchange in the EU other than in Germany to exercise their right of choice in favour of Germany as their Home Member State. At the same time such issuer will be required to comply with the full range of continuing obligations resulting from listing under German securities laws, including, in particular, financial reporting, disclosure of price sensitive information, major shareholdings etc. Non-EU issuers listed in more than one EU Member State may be able to choose their Home Member State but will still be required to comply with the reporting obligations of the chosen jurisdiction.

Issuers listed not only in EU Member States but also outside the EU may consider a delisting from European stock exchanges if they are not inclined to implement and comply with the European set of continuing obligations resulting from a listing on a regulated market within the EU.

3. Review of the Prospectus Directive

The Prospectus Directive 2003/71/EC (PD) requires the European Commission to review its application five years after its entry into force. In view of such formal requirement and the continuous dialogue with market participants, the Committee of European Securities Regulators (CESR) and the European Securities Markets Expert Group (ESME), in January 2009 the European Commission has issued a draft proposal for amendments to the PD and a background document meant (i) to provide a general assessment of the overall functioning of the PD, (ii) to explain the proposed actions addressing specific problems, which were identified and (iii) to request contributions and suggestions for other issues where the Commission did not include specific proposals at this stage of the draft proposal.

Specific amendments intend to:

- align the definition of "qualified investors" under the PD for purposes of private placements with the categories of "professional clients" and "eligible counterparties" under the MiFID;
- delete the 1.000 EUR threshold which limits the free determination of the Home Member State for issues of non-equity securities;
- clarify the requirement to publish a prospectus where securities are offered and sold to investors by intermediaries and not directly by the issuer itself (retail cascade);
- widen the exemption from the prospectus requirement related to employee share schemes in order to cover schemes of companies that are not listed on a regulated market;

- harmonise throughout the EU Member States the time frame for the exercise of the withdrawal right triggered by a prospectus supplement (two working days);
- abolish the obligation to publish annually a document referring to all information published in the preceding twelve months *("Jährliches Dokument")*.

Other issues where the Commission did not include specific proposals at this stage of the draft but requests contributions from market participants relate to:

- the effectiveness of the prospectus summary;
- disclosure obligations for retail investments products (White Paper envisaged for April/May 2009);
- a relaxed disclosure regime for small quoted companies (increase of the 2.5 million EUR threshold or "mini prospectus")
- an exemption from requirement to provide additional information on the guarantor where EU Member States act as guarantors;
- an exemption of rights issues from the prospectus requirement where a document is available containing information on the reason for and the details of the offer.

Useful link:

Consultation and background document:
http://ec.europa.eu/internal_market/consultations/2009/prospectus_en.htm

4. BaFin consults draft of revised Issuer Guidelines *(Emittentenleitfaden)*

The German securities regulator BaFin has issued and consulted a revised draft of its Issuer Guidelines. The existing Issuer Guidelines document dated 15 July 2005 reflects the regulator's view on specific issues of the German "being public" regime. BaFin has (i) updated the existing chapters on price sensitive (ad hoc) information, directors' dealings and insider rules in particular taking into consideration the implementation of the European Transparency Directive and (ii) substantially extended such document with respect to the following issues which were not covered in the 2005 guidelines:

- Disclosure of major shareholders and voting rights;
- Enforcement of accounting rules, appellate procedures against BaFin and co-operation by BaFin with other public authorities and foreign securities regulators within enforcement proceedings;
- Financial reporting;
- Disclosure of other information required for the exercise of investors' rights.

The content of the revised guidelines will be dealt with under separate cover.

Useful link:

BaFin consultation on revised Issuer Guidelines *(Emittentenleitfaden)*:
http://www.bafin.de/cln_109/nn_724058/SharedDocs/Veroeffentlichungen/DE/Unternehmen/Konsultationen/2008/kon__1508__Emittentenleitfaden.html

5. New banking license requirement for collective portfolio management

A ruling issued by the Federal Administrative Court *(Bundesverwaltungsgericht)* in February 2008 had rejected a broad interpretation of the regulated and therefore licensable banking activities defined in the German Banking Act *(Kreditwesengesetz)*. In a quite uncommon rush the German government has presented several consecutive proposals on the amendment of the German Banking Act extending the list of regulated activities and meant to cover certain closed ended funds structures of the grey capital markets. The Act on the Development of the Law of Mortgage Bonds *(Gesetz zur Fortentwicklung des Pfandbriefrechts)* which came into effect on 26 March 2009 (BGBl. I No. 16 of 25 March 2009 p. 607) and carries the amendment to the German Banking Act has finally introduced a new licensable activity which is the "Collective Portfolio Management" *("Anlageverwaltung")*.

Such activity falls in the category of financial services and is defined as *"the acquisition and disposal of financial instruments for a community of investors with discretion as to the selection of the financial instruments, provided that such activity constitutes the main focus of the offered service and the investors are intended to participate in the performance of the portfolio."*

This language, although much more precise than the preceding drafts, still leaves several doubts as to the scope of its applicability. In particular, neither the wording nor the official reasoning of the amendment provides guidance as to when acquisitions or disposals need to be regarded as a service for third parties ("for a community of investors") as opposed to the management of own assets. This issue will need to be answered in particular with respect to non-German fund structures where the fund entity has legal capacity and wants to market its interests in Germany. The distribution of interests in non-German open ended funds which qualify as "foreign investment funds units" *("ausländische In-*

vestmentanteile") under the German Investment Act *(Investmentgesetz)* are exempted from the new license requirement, though.

On 30 March 2009, BaFin has issued a preliminary circular setting out its position as to this new license requirement. A more detailed document *(Merkblatt)* shall be elaborated and published by the German regulator in due course.

Useful links:

Act on the Development of the Law of Mortgage Bonds *(Gesetz zur Fortentwicklung des Pfandbriefrechts)*: *http://frei.bundesgesetzblatt.de/index.php?teil=I&jahr=2009&nr=16*

BaFin circular on collective portfolio management: *http://www.bafin.de/cln_109/nn_721290/SharedDocs/Veroeffentlichungen/DE/Service/Rundschreiben/2009/rs__0907__wa__anlageverwaltung.html?__nnn=true*

6. BaFin circular on scope of German Investment Act

One of the core amendments to the German Investment Act taking effect at the beginning of 2008 was to provide for a more formal definition of foreign investment fund units. According to such amendments, the German Investment Act applies to funds

- meant for collective investment,
- invested according to the principle of risk diversification
- in eligible assets and
- governed by the laws of a foreign jurisdiction
- with the participation being issued by an entity domiciled outside Germany
- where (i) the investors have a right of redemption or (ii) the fund is subject to an investment supervision in its home jurisdiction.

On 9 June 2008, the German securities regulator BaFin had issued a draft circular to illustrate its interpretation of the aforesaid statutory requirements. Following intensive discussions by market participants, on 22 December 2008 BaFin released the final circular on the scope of applicability of the German Investment Act on foreign investment funds.

Apart from numerous editorial clarifications BaFin's position in the December 2008 circular differs from the draft circular, in particular with respect to the recognition of an investment supervision in the funds home jurisdiction. If no redemption right is granted to the investors (closed ended structure) the German Investment Act will govern the distribution of the fund units if the supervision of the fund extends to at least

- the standing of the fund prior to its marketing,
- the reliability and qualification of the funds management staff, and
- the ongoing monitoring of compliance with applicable investment restrictions.

Compared to the preceding draft the final guidelines do not accept such investment supervision where one of these criteria is met but as a matter of principle require all of them to be complied with under the funds home jurisdiction.

Useful link:

BaFin circular dated 22 December 2008 on the scope of the German Investment Act: *http://www.bafin.de/cln_109/nn_724240/SharedDocs/Veroeffentlichungen/DE/Service/Rundschreiben/2008/rs__1408__wa.html*

7. Government presents draft bill on the law of bonds

On 18 February 2009 the German Federal Government presented a draft bill on the issuance of bonds meant to replace the existing act on the law of bonds which act substantially remained unchanged since 1899. Following a period of silence after the first draft *(Referentenentwurf)* of May 2008, the Federal Government has reconsidered formerly proposed changes, in particular taking into consideration lessons learned from the financial crisis.

According to the draft bill, the new rules will cover not only bonds issued by German issuers, but apply to bonds where the terms and conditions of the bond are governed by German law. The draft bill aims at vitalizing the powers of creditors and facilitating majority decisions of the creditors by

- abolishing the crisis of the issuer as a requirement for any change of the creditors' rights by majority vote,
- extending the list of topics on which the creditors meeting can resolve with a majority of votes
- facilitating the implementation of a joint representative of the creditors (e.g. in the terms and conditions) and
- aligning the process of the calling and voting in a creditors meeting and challenging respective reso-

lutions with the laws governing shareholders' meetings of stock corporations.

Furthermore, a newly incorporated principle of transparency is meant to ensure comprehensibility of the terms and conditions and the specific undertakings by the issuer. Since the comprehensibility test refers to an "investor who is knowledgeable about the specific type of bond" the level of knowledge to be assumed in a specific case will need to be determined in the course of the legislative procedure or by courts later on.

The legislative procedure shall be finalized in summer 2009.

Useful link:

Draft bill on the law of bonds:
http://dip21.bundestag.de/dip21.web/searchProcedures/simple_search_list.do?selId=18426&method=select&offset=0&anzahl=10&sort=3&direction=desc

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