

Capital Markets Update

Client Letter

v. BOETTICHER HASSE LOHMANN

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Germany: Announced bill on investor protection and transparency

On March 3, 2010, Wolfgang Schäuble, the German Minister of Finance, announced a draft bill aiming to strengthen investor protection and improve the functional integrity of the capital markets. Such bill is still motivated by deficits in financial regulation allegedly experienced during the financial crisis and is meant to complement the international attempts to improve the financial market regulation.

According to the announcement, the proposed legislation will address the following topics and implement the following requirements:

Investor Protection

- Investment advice and brokerage services provided with respect to instruments of the **grey capital markets** (*Grauer Kapitalmarkt*) shall **no longer be exempted from the requirements of the German Securities Trading Act** (*Wertpapierhandelsgesetz – WpHG*). In particular, interests in **closed ended funds** will qualify as financial instruments under the German Securities Trading Act.
- The required level of information to be provided in **prospectuses on instruments of such grey capital markets** will be increased; their review by BaFin shall extend from completeness to coherence.
- A **registration requirement for investment advisors** taking responsibility for marketing instructions of financial institutions shall be implemented in order to enable their individual supervision.

Short Selling

- **Naked short sales** shall be generally prohibited.
- **Covered short sales** shall be subject to disclosure.

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Stake Building

- In order to prevent undisclosed stake building prior to take over offers the disclosure regime governing **disclosure of major shareholdings shall be extended** to financial instruments which currently are not subject to disclosure (e.g. **cash settled swaps and stock lending transactions**).

Open Ended Real Estate Funds

- A **minimum holding period of two years** shall be introduced for investments in open ended real estate funds under the Investment Act (*Immobilien-Sondervermögen*).
- Open ended real estate funds shall no longer be allowed to offer **redemption of interests** on a daily basis but will need to provide for **notice periods between 6 and 24 months**. Liquidity requirements will depend on the applicable notice period for redemption requests in order to prevent longer periods of suspended redemption.
- In case keeping the fund open is not ensured sustainably **advanced liquidation proceedings** shall be implemented.

The Ministry of Finance (*BMF*) announced to present the draft bill in April 2010.

Useful link:

Press release issued by *BMF* on the contents of the draft bill:

http://www.bundesfinanzministerium.de/nr_54090/DE/Presse/Pressemitteilungen/Finanzpolitik/2010/03/20100303_PM08.html

Germany: Proposed annual audit of credit rating agencies

On January 13, 2010, the federal Government resolved a draft bill on the implementation of the Regulation (EC) No 1060/2009 on credit rating agencies.

Such EU Regulation provides for the first time a uniform European regulatory framework for rating agencies. Its core elements consist of a registration procedure to be passed by all rating agencies prior to operating within the territory of the European Union and substantive regulation on the avoidance of conflict of interest and disclosure of analysis methods, models and ownership structure (for more details see vBHL – Corporate/Capital markets Update December 2009). The supervision and enforcement of such substantive requirements has been left to the European Member States until 2011 when the

European Securities and Markets Authority (ESMA) will take over such supervision.

Not surprisingly the draft bill on the implementation of the Regulation determines the Federal Financial Supervisory Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht – BaFin*) to be the competent national authority for the supervision of rating agencies until 2011 and provides for a catalogue of administrative offences relating to the substantive requirements set out in the EU Regulation on rating agencies.

Unexpectedly the draft bill provides for an obligatory **annual audit of rating agencies** registered in Germany. Such annual audit shall

- be conducted by a qualified **accounting firm to be mandated by BaFin** and
- generally cover “**compliance with the requirements under Regulation (EC) No 1060/2009**” with specific focuses to be indicated by BaFin.

Depending on the implementation of the EU Regulation in other European member States this again may lead to a competition of European jurisdictions.

Useful links:

Draft bill issued by the Federal Government:

http://www.bundesfinanzministerium.de/nr_54/DE/Wirtschaft_und_Verwaltung/Geld_und_Kredit/100113_Ratingagenturen.html?_nnn=true

Germany: BaFin decree on transparency of net short selling positions

The General Decrees issued by the Federal Financial Supervisory Authority (*BaFin*) on the general ban of uncovered short sales in eleven stocks have expired at the end of January 2010.

On March 4, 2010, *BaFin* issued a new General Decree on the **disclosure of net short selling positions**:

The disclosure requirement applies to all transactions which, in terms of the holder's aggregate economic interest, result in a net short selling position in shares of the following companies:

- Aareal Bank AG
- Allianz SE
- Generali Deutschland Holding AG
- Commerzbank AG
- Deutsche Bank AG
- Deutsche Börse AG
- Deutsche Postbank AG

- Hannover Rückversicherung AG
- MLP AG
- Münchener Rückversicherungs-Gesellschaft AG

The decree provides for a two-tier transparency system: first, **net short selling positions of 0.2 % or more of the shares in issue of the specified companies must be notified to BaFin**. Further notifications are required when such positions reach, exceed or fall below a further 0.1 % in each case. In addition, **reported net short selling positions of 0.5 % or more will be displayed in anonymised form on the BaFin homepage**.

In addition to covered and uncovered short-selling transactions in the shares concerned, the provision also applies to other positions of financial instruments traded on the stock exchange or over-the-counter which ultimately correspond to a short selling position in shares (**e.g. sale of futures, purchase of put options, contracts for difference, regardless of whether physical delivery or cash settlement takes place**). Also subject to notification and disclosure are the respective holders of the positions.

The decree enters into force on March 25, 2010, 0.00 hrs., and initially will apply until January 31, 2011, 24.00 hrs. The transparency regime created by such General Decree, is based on the proposals published on March 2, 2010 by the Committee of European Securities Regulators (CESR) for a pan-European transparency system for net short selling positions.

Useful links:

BaFin decree on transparency of net short selling positions:
http://www.bafin.de/clin_161/nn_720486/SharedDocs/Artikel/EN/Service/Meldungen/meldung_100304_leerverk_transparenz_en.html?_nnn=true

EU: Status of Prospectus Directive review

In September 2009 the European Commission published its proposals for amending the Prospectus Directive (2003/71/EC). As this proposed Directive is subject to the co-decision procedure, both the Council of Ministers and the European Parliament are now in the process of reviewing it. Below please find the **major open issues** of the review process basically reflecting the Council Presidency's compromise proposal of December 2009 ("Council") and the publication of the draft report of the Rapporteur to the Committee on Economic and Monetary Affairs of the European Parliament of January 2010 ("report to Parliament").

- **Prospectus summary:** While Council proposes to abolish the **2,500 word limit**, to require the summary to provide comprehensive "**key information**" and to extend the **liability** for the summary, the report to Parliament supports the abolition of the 2,500 words limit but rejects an extension of the liability and proposes to specify "key information" on level two based on the outcome of the Packaged Retail Investment Products (PRIPs) initiative.
- **Rights issues:** While Council proposes to allow a reduced prospectus ("**mini prospectus**") for issues restricted to existing shareholders, the report to Parliament favours a **general exemption** of rights issues from the prospectus requirement.
- **Prospectus supplements:** In the case of a prospectus produced both for a public offer and an admission to trading, the Directive currently requires a supplement if the new development occurs before the admission to trading or the closure of the offer but does not specify whether it is the earlier or the later of these dates. The Council proposes explicitly stating what has probably always been supported by the majority view, namely that the period should end on **whichever is the later** of these dates. However, the report to Parliament takes the opposite view, namely that the period should end on **whichever is the earlier** of these dates.
- **EUR 50,000 and EUR 1,000 thresholds:** The EUR 50,000 minimum denomination threshold is most widely used by issuers when making a public offer of non-equity securities if they do not want to be obliged to publish a prospectus. While Council proposes **raising it to EUR 100,000** the report to the Parliament does not propose any change to the existing threshold. A EUR 1,000 minimum denomination threshold is used in the Directive to distinguish whether the issuer has the ability to choose its home member state on an issue-by-issue basis. While Council proposes retaining the existing threshold the report to Parliament proposes **abolishing this threshold**, so that all issuers of non-equity securities get to choose on an issue-by-issue basis.
- **Employee share schemes:** Employee participation schemes generally constitute offers requiring the publication of a prospectus under the Directive. While there is an exemption for companies which already have securities admitted to trading on a regulated market within the EU, there is no exemption available for other companies, such as large multinational groups which do not have any

securities admitted to trading on a regulated market in the EU in case, for example, their shares are listed on the New York or Tokyo stock exchange. Council and the report to Parliament propose extending the current exemption to all employee share schemes. However, Council proposes a much more limited extension of the current **exemption: in the case of issuers from outside the EU**, only if the Commission has made a determination of equivalence between the market on which the company's shares are admitted to trading and a regulated market; and in the case of issuers whose shares are admitted to trading on multilateral trading facilities (MTF), only if the MTF satisfies certain requirements relating to transparency and market abuse.

- **Validity period:** Currently a prospectus is valid for up to 12 months after its publication. While Council proposes that this 12-month period should instead run from the date of approval of the prospectus, the report to Parliament proposes extending the validity period to **36 months** for a base prospectus for a program and to **24 months** for any other prospectus.

The expectation is to finalize and enact the amendment to the Prospectus Directive in 2010.

EU: 10th Update of CESR Q&A re Prospectuses

In December 2009 the Committee of European Securities Regulators (CESR) issued the 10th updated version of common positions agreed by the CESR members regarding prospectuses under the Prospectus Directive 2003/71/EC in the form of a Q&A paper (Ref. CESR/09-1148). This paper adds only one additional common position on free offers to those included in the previous Q&A document published in September 2009:

According to the newly inserted position on **free offers to employees**, CESR clarifies by way of precaution that where the offer does not fall within the definition of an "offer to the public" (art. 2.1 (d) PD) or the offer is exempted based on the total consideration exemption (art. 1.2 (h) PD or art. 3.2 (e) PD) **no information document** within the meaning of art. 4.1.d and 4.1.e of the Prospectus Directive needs to be made available.

Please note that *BaFin* does not generally share CESR's position that free offers do not fall within the definition of an "offer to the public" or are exempted due to their zero consideration.

Useful link:

10th Update of CESR Q&A (CESR/09-1148):

http://www.cesr-eu.org/index.php?page=document_details&id=6472&from_id=40

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This Client Letter is intended to highlight issues and not to be comprehensive, nor to provide legal advice. Should you have any questions on issues reported here or on other areas of law, please contact the person named under "Key Contact", or your usual contact at v. Boetticher Hasse Lohmann.

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