

The EU Prospectus Regulation and German “Implementing” Legislation – More Flexibility for Issuers, Tougher Sanctions and a More Powerful Regulator

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While the EU Prospectus Regulation (the “Regulation”) is directly applicable European law and will generally apply in full throughout the EU from July 21, 2019 without further implementation into national law, the Regulation still requires various amendments to German law which we will discuss in this memorandum.

To recap, the Regulation is the result of the European Commission’s endeavor to “modernize the Prospectus Directive”, first announced in September 2015 in its Action Plan on Building a Capital Markets Union. The Regulation provides EU Member States with certain options and discretion to be exercised in national law. In addition, Member States have a mandate to impose effective, proportionate and dissuasive administrative sanctions in case of infringements of the Regulation. Member States must also ensure that national competent authorities have the investigatory and supervisory powers necessary to enforce, and fulfill their tasks under, the Regulation.

In Germany, a first set of changes to the German Securities Prospectus Act (*Wertpapierprospektgesetz* – “WpPG”) and certain other laws has been adopted in the *Gesetz zur Ausübung von Optionen der EU-Prospektverordnung* (“First Implementing Act”). Further changes to the WpPG will be set forth in the *Gesetz zur weiteren Ausführung der EU-Prospektverordnung* (“Second Implementing Act”) which is currently available as draft bill (*Regierungsentwurf*).

In the following, we first summarize certain key changes to the disclosure regime for securities offerings resulting from the Regulation. We then discuss changes to the WpPG set forth in the First and Second Implementing Act.

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The Regulation

The Regulation introduces the following key changes to the currently applicable German and EU regulatory regime governing securities prospectuses:

- *Exemptions from prospectus requirement:* The Regulation extends the availability and scope of exemptions from the prospectus requirement. It introduces the “simplified disclosure regime” for secondary issuances of securities, for which a “simplified prospectus” may be used, and a “proportionate disclosure regime” for certain small and medium-sized companies, which may use an “EU Growth Prospectus”.
- *More concise prospectuses:* The Regulation aims at cutting down on the length of prospectuses by, *e.g.*, limiting the length of the summary and the number of risk factors to be included in the summary.
- *More specific risk factors:* The Regulation is designed to improve the informative value of prospectuses by limiting the risk factor section to risks which are material, specific to the issuer and/or to the securities and corroborated by the content of the prospectus.
- *Universal registration document:* Certain seasoned issuers may prepare and publish a “universal registration document” which may be used both as part of a prospectus consisting of separate documents and, subject to certain conditions, for the purpose of fulfilling an issuer’s obligation to publish annual and semi-annual financial reports under the Transparency Directive.
- *Level 2 and 3 acts:* The Regulation authorizes a set of Commission delegated acts (level 2 acts), and requests administrative guidance (level 3 acts) from the European Securities and Markets Authority (“ESMA”), all currently only available in draft form. Certain provisions of the draft delegated acts and guidance are heavily debated among market participants. Among these are the removal of the

requirement that profit estimates or forecasts may only be included in a prospectus if accompanied by an auditor’s report (as provided in the draft Commission delegated regulation on the format, content, scrutiny and approval of prospectuses) and the increased level of substantive scrutiny expected from national competent regulators, including the German Federal Financial Supervisory Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht* – “BaFin”) (as reflected in the draft ESMA guidelines on risk factors).

- *Options, discretion and mandates for Member States:* As noted above, Member States must exercise options and discretion regarding certain exemptions from the prospectus requirement for small issuances and the prospectus language regime. In addition, national legislators must adopt a regime of effective, proportionate and dissuasive administrative sanctions and give the necessary investigatory and supervisory powers to national competent regulators, all as more fully described below.

For a detailed analysis of the changes in the disclosure regime resulting from the Regulation, follow this [link](#) to our alert memorandum titled “The New Prospectus Regulation – The Story So Far”.

The First Implementing Act

Germany has exercised certain options and discretion granted in the Regulation through amendments to the WpPG set forth in the First Implementing Act which entered into effect as of July 21, 2018 together with certain provisions of the Regulation. These amendments include, *inter alia*, exemptions from the prospectus requirement for certain small issuances, introduction of the requirement to prepare and publish a securities information document (*Wertpapier- Informationsblatt*) for certain issuances exempt from the prospectus requirement and changes to the prospectus language regime. Among the key amendments are the following:

- *Exemptions from prospectus requirement:* In order to allow small and medium-sized businesses to tap the capital markets more cost-effectively, offerings of securities to the public are exempt from the prospectus requirement if the total consideration received by an issuer in the EEA is less than EUR 8 million (calculated over a 12 months-period) (“Small Issues Exemption”), subject to the following requirements and restrictions:

- Where the total offer consideration is at least EUR 100,000 (but less than EUR 8 million), the issuer is obliged to draw up and publish a securities information document. The securities information document must not exceed a maximum of three pages of A4-sized paper, must contain certain information on the issuer and the securities offered and is subject to BaFin approval. Short, fact-based and limited to providing only material information, the securities information document is intended to qualify as “other disclosure requirement[s]” within the meaning of the Regulation which Member States are authorized to introduce provided that such requirements do not constitute a “disproportionate or unnecessary burden” for the issuer. The securities information document is subject to the same liability regime as prospectuses, and BaFin may impose a fine should securities be offered without publication of an approved securities information document, where approval and publication of such document is required.
- So far, in cases in which the total offer consideration is at least EUR 1 million or more (but less than EUR 8 million), the securities may only be marketed to retail investors in reliance on the Small Issues Exemption by a licensed investment firm rendering investment advice or investment brokerage services and within narrow investment limits for each retail investor. Should the Second

Implementing Act be enacted as proposed, the additional restrictions for retail investors will no longer apply in the case of a public offering of shares to existing shareholders from a rights offering for a total consideration of less than EUR 8 million. The requirement to publish an approved securities information document remains unaffected.

While prior to the First Implementing Act, CRR credit institutions and issuers whose shares are already listed on a regulated market benefitted from an exemption from the prospectus requirement not only for the public offering, but also for the listing of securities issued throughout the EEA for a total consideration of less than EUR 5 million (calculated over a 12 months-period) (“Bank/Listed Issuer Exemption”), such exemption has been limited to public offerings by the First Implementing Act. No securities information document has to be published in connection with a public offering made in reliance on the Bank/Listed Issuer Exemption. Should the Second Implementing Act be enacted as proposed, the scope of the Bank/Listed Issuer Exemption will be extended to the public offering of securities issued throughout the EEA for a total consideration of less than EUR 8 million, calculated over a 12 months-period.

- *Prospectus language:* Prior to July 21, 2018, as a general rule, prospectuses for a public offering of securities in Germany (only) or a listing on a regulated market in Germany (only) had to be drawn up in German. Although BaFin was authorized to grant an exemption and permit the use of an English language prospectus (with a German language translation of the summary) on a case-by-case basis in very narrow circumstances, such exemption was of little practical relevance. Rather, issuers would rely on the right to use an English language prospectus (with a German language translation of the summary) for a dual public

offering (*i.e.*, a public offering in Germany and one additional EEA jurisdiction) or a dual listing (*i.e.*, a listing on a regulated market in Germany and one additional EEA jurisdiction). The First Implementing Act has liberalized the language regime:

- In connection with public offerings in Germany (only), the restrictive conditions applicable to the exemption to be granted by BaFin on a case-by-case basis have been removed resulting in broader discretion on the part of BaFin when considering an exemption.
- In connection with listings on a German regulated market (only), the prospectus may be drawn up in English (with a German language translation of the summary) without having to obtain any further exemption.

The Second Implementing Act, if enacted as proposed, will further relax the prospectus language regime, as more fully described below.

The (Draft) Second Implementing Act

On January 23, 2019, the German Government approved the draft bill (*Regierungsentwurf*) of the Second Implementing Act. It has been submitted to the German parliament (*Bundestag*) for discussion and adoption and is expected to enter into effect by July 21, 2019 (when the Regulation will apply in full). The Second Implementing Act aims at completing the amendments to the WpPG and certain other laws necessary to ensure consistency with the Regulation. The Second Implementing Act will result in a complete overhaul of the WpPG, essentially removing the provisions dealing with the prospectus requirement, as well as the preparation, format, publication and approval of prospectuses which will in future be subject to the Regulation. In addition, the Second Implementing Act will amend the scope of the Small Issues Exemption and the Bank/Listed Issuer Exemption as well as the prospectus language regime. And it will grant to BaFin more far-reaching supervisory powers and introduce a new regime of regulatory sanctions. The key changes are as follows:

- *Complete overhaul of the WpPG:* As of today, the WpPG sets forth, among other things, the regulatory framework applicable to the requirement for, as well as the format, publication and approval of, securities prospectuses in Germany, as well as advertisements related to securities offerings. Once in full force and effect, the Regulation will replace the WpPG in these areas. From July 21, 2019, the revised WpPG (“WpPG-NEW”) will thus be limited to setting forth certain exemptions from the prospectus requirement, the regulation of the securities information document, the liability regime applicable to prospectuses and securities information documents, as well as the supervisory powers and the sanctions regime relating to violations of the Regulation and the WpPG-NEW.
- *Exemptions from prospectus requirement:* The Second Implementing Act will extend the scope of the Small Issues Exemption and the Bank/Listed Issuer Exemption, as more fully described above.
- *Prospectus language:* The language regime for securities prospectuses will be further liberalized to permit the use of an English language prospectus (with a German language translation of the summary) in connection with the public offering of securities in Germany or the listing on a regulated market in Germany without any additional requirements (Sec. 21(2) WpPG-NEW). In particular, issuers will no longer have to obtain a BaFin exemption or engage in a dual offering or dual listing as a prerequisite for using an English language prospectus (with a German language translation of the summary) in connection with a public offering or listing of securities in Germany.
- *Supervisory powers:* BaFin’s supervisory powers will be significantly strengthened. Among other things, if necessary to ensure compliance with the WpPG-NEW and the Regulation, BaFin will be authorized to request information and documents from any

person (rather than from certain market participants only as is currently the case). In addition, BaFin's powers to prohibit public offerings will be significantly extended. While under the WpPG as currently in effect, an offering will be prohibited if, among other things, a prospectus or securities information document, although required, is missing or has not been approved, the Second Implementing Act will authorize BaFin to prohibit, in its discretion, public offerings in any other cases in which the WpPG-NEW or the Regulation has been, or may reasonably be expected to be, violated. However, when exercising its discretion, BaFin must act in a suitable, reasonable and proportionate manner. Thus, the prohibition of an offer should only be expected in particularly serious cases of non-compliance with WpPG-NEW. Also, consistent with BaFin's powers under the market abuse regime, under the WpPG-NEW, BaFin will be authorized, subject to certain conditions, to have its representatives enter and search business premises and, in connection with a search, seize objects if necessary to investigate violations of the Regulation, provided that relevant evidence may reasonably be expected to be found.

- *Sanctions regime:* Under the WpPG as currently in effect, BaFin may impose a maximum fine of up to EUR 500,000 where an offering is made, although the required prospectus or securities information document is missing or has not been approved. The Second Implementing Act will introduce significantly more severe sanctions that may be triggered by a much broader spectrum of violations of prospectus- and offering-related requirements than is currently the case. The following aspects of the sanctions regime of the WpPG-NEW are particularly noteworthy:
 - First, in line with a general trend in capital markets law and as required by the Regulation, the amount of fines BaFin may impose will be increased significantly. More precisely, BaFin may impose fines of up to EUR 700,000 (in the case of individuals, such as, for example, directors and officers acting on behalf of an issuer or an offeror) or, in the case of legal entities, the higher of EUR 5 million or 3% of the total annual turnover of the entity. (Probably due to an oversight of the legislator, the Second Implementing Act as currently drafted does not refer to the total annual turnover of the corporate group where the relevant entity forms part of a group, although so required by the Regulation. The Second Implementing Act may be amended in that respect in the course of the completion of the legislative proceedings.) In addition, in relation to both individuals and legal entities, the fine may reach twice the amount of the profits gained or losses avoided because of the violation of the Regulation or the WpPG-NEW (Sec. 24(5), (6) and (7) WpPG-NEW). The amount of potential fines will significantly increase the risks associated with any non-compliance with the provisions of the Regulation or the WpPG-NEW.
 - Second, sanctions may be imposed for a wide range of violations of the Regulation and the WpPG-NEW committed with intent or gross negligence or, in some cases, ordinary negligence. Depending on the specific violation, and in accordance with general principles, sanctions may be imposed on issuers, offerors and other persons (including individuals) involved in the wrongdoing.
 - Third, under the WpPG-NEW, in certain circumstances, the publication of an incomplete or incorrect prospectus may result in significant administrative fines for the parties involved and not only trigger prospectus liability claims against the issuer and the offerors as under current law. For example, pursuant to Sec. 24(4) Nos. 2, 3 and 16 and Sec.

24(6) WpPG-NEW, BaFin may impose a fine if the content, presentation or format of the summary or body of a published prospectus fail to meet the requirements set forth in Art. 6, 7 or 16 of the Regulation. This development marks a paradigm shift away from the traditional focus of the approval process on mere formal compliance with the prospectus requirements and consistency of the various prospectus parts. It is, however, in line with the increased level of (substantive) scrutiny that BaFin (like any other national competent authority) seems to be expected to apply in connection with the prospectus approval process going forward. Should sanctions be imposed as a result of an intentional or grossly negligent violation of specific disclosure requirements, this may increase the risk that investors bring prospectus liability claims.

- Finally, the sanctions regime set forth in the WpPG-NEW may result in a situation where an administrative fine is imposed on the issuer based on a breach of applicable disclosure requirements, even if compliance with such disclosure requirements has been reviewed in the prospectus approval process. In practice, such a situation should only arise if BaFin becomes aware of an inaccuracy or omission of information only after the approval. Potentially, BaFin could be made aware of a prospectus error through a prospectus liability claim brought by an investor or through a tip given to BaFin by a competitor intending to hurt the issuer or by an investor who is unsure whether to bring a prospectus liability claim but eager to test BaFin's view on the matter. Similarly, investors may become aware of errors or omissions contained in a prospectus, should BaFin publish fines imposed in accordance with the naming and shaming regime of the Regulation and the WpPG-NEW. Such publication may encourage investors to

raise prospectus liability claims. It remains to be seen how the sanctions regime introduced by the WpPG-NEW will ultimately affect the relationship between private and public enforcement in the prospectus space and how BaFin guidance and practice will evolve over time.

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