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## **Finance for your clients: Harmonisation of Capital Markets**

**Commission(s) in charge of the Session/Workshop:**

**BANKING, FINANCE AND CAPITAL MARKETS**

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### **National Report of Germany**

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**1. Briefly describe the level of integration of the capital markets at the infra-national, national and supra-national levels.**

Generally, the level of integration of capital markets in the euro zone is rather high, which results from steady legal alignment efforts and its corresponding provisions.

Since the early 2000s the European market was characterized by ongoing harmonisation measures and it still is today. There are two important directions of legal developments: Firstly, the alignment efforts regarding consolidation of the markets (e.g. Action Plan on Capital Markets Union, MIFID I/II) and secondly, strengthening market supervision and protection from abuse and manipulation (e.g. MAR, CRR).

The recent developments are dominated by lessons from the financial crisis, for example the Market in Financial Instruments Directive (MIFID) is a direct result of the huge losses caused by certificates sold to consumers, trying to increase the fair treatment of bank's customers as well as the information they receive.

Despite the general legal alignment tendencies on the European level, there would still room for some leeway it comes to legal implementations on the national level to the extend total integration of the capital markets in the EU would be the aim. Hence, differences in law can still be found, but mid of 2016 those will be smaller than ever before.

However, there are still some legal and practical hindrances, when it comes to supranational capital transfers and capital markets - strongly depending on the countries involved. Great Britain, for example, is part of the European Union but does not use the Euro, which results in exchange rates and connected risks and difficulties.

To sum it up, the integration of capital markets on the European level is rather high, particularly if compared to the international market.

With regard to the national integration of capital markets in Germany, the level is considerably higher as it is fully consolidated and lacks the legal and practical hindrances of supranational markets. The infranational (i.e. regional) level does not differ from the national level in Germany.

- 2. Which measures have been adopted (or are foreseen) in your jurisdiction to support access to finance by small and medium sized enterprises (“SMEs”)?** Measures might include (i) supporting venture capital and equity financing; (ii) lowering information barriers; (iii) enhancing access to public markets; (iv) supporting equity financing; (v) facilitating infrastructure investment; and/or (vi) promoting innovative forms of corporate financing.

As mentioned, the main tendency of developments in the last decade rather leads towards the enhancement of investor protection than to the facilitation of easy funding. For, critical voices have been blaming the lax provisions especially regarding investor information for causing historical cases of investment fraud, e.g. in Germany the Prokon bankruptcy, which had its roots in the “grey capital market”. On the other side this - naturally - increases the burden for issues to gain access to funds on the capital markets and thus there are more and more voices in the legal and political environment demanding a simplification of practical barriers in particular for SMEs. However, as most of the restrictions are based on EU regulations and directives even if German politics would go make more efforts to ease the burden for SMEs, the areas which can be influenced on a national level are limited.

#### i) Crowdfunding

Most recently regulation for startup financing via crowdfunding was introduced, extending national prospectus requirements to popular crowdfunding measures like sub-ordinated loans. However, in order not to prevent SMEs from crowdfunding possibilities there are some reliefs from the prospectus obligation. They apply when the enterprise does not raise more than EUR 1 million, the investment is offered via an internet platform and any (private) investor cannot invest more than EUR 10,000. In case of an investment, which is between EUR 1,000 and EUR 10,000, the investor has to give a self-disclosure that he personally holds cash assets worth at least EUR 100,000 or the investment is not higher than two times of his average monthly net income.

Additionally, for every investment higher than EUR 250 the enterprise has to send a key information document to the investor, which has to be signed by the investor and sent back to the enterprise.

## ii) Securities Prospectus requirements

According to Sect. 3 para. 2 WpPG and Sect. 7 WpPG in conjunction with Annexes XXV-XXVIII VO (EG) 809/2004, SMEs can reduce the level of information in a securities prospectus. Notably, in a debt issue or an equity issue, no interim financial information needs to be disclosed as long as the end of the last financial year, for which certified annual accounts are available, was less than 15 months before approval of the prospectus. For non-SMEs it is 9 instead of 15 months.

## iii) Enhancing access to public markets

The European Commission recently introduced an action plan on a Capital Markets Union which includes measures to enhance access to public markets for SME. One part of this action plan is, to simplify the prospectus regime, another one is the promotion of venture and equity capital financing methods. In particular it is proposed that issues up to EUR 500,000 within 12 months shall not require a prospectus at all and that EU member states may - but need not - release public offers of up to EUR 10 million from prospectus requirements.

### **3. Has your jurisdiction adopted (or are there any trends indicating that may do so in the future) any measures to remove barriers to cross-border investment? Measures could include (i) improving market infrastructure; (ii) fostering convergence of insolvency proceedings; (iii) removing cross-border tax barriers; (iv) strengthening supervisory convergence.**

The leading legislative changes and amendments take place on the EU level, with the EU being its driving force. Therefore, this is the level to consider preferably. The actual focus of legislative changes and amendments on the EU level lies rather on increasing security and reliability of capital markets (ESMA, MIFID I/II, MIFIR) than on consolidation through simplification. Nevertheless, the Capital Markets Union is pursued by EU with its action plan on capital markets union (CMU) - as already mentioned in question 2. So, there are measures to strengthen and improve common regulations, for example concerning the unregulated market ("grey market"). These measures apply to all EU countries and hence have equalizing effects on the markets. Of course, this goes along with supervisory convergence as well.

#### (i) Improving market infrastructure

The European Market Infrastructure Regulation (EMIR) mainly deals with OTC trading and stipulates for example a clearing obligation, i.e. trading via a central counterparty (CCP), a risk management and a reporting obligation to a transaction register. In the end, this results in disclosure obligations in order to make these markets more transparent.

(ii) Fostering convergence of insolvency proceedings

There have been measures to achieve progress on the way to a uniform insolvency proceeding/law in the EU, for example the EU regulation on insolvency proceedings (1346/2000/EG), which first covers the need to prevent the transfer of insolvency proceedings to the most favourable jurisdiction only, i.e. the strict determination of the country concerned. So, there is an intended convergence of insolvency law on EU level, but it is not as advanced as it could be.

(iii) Removing cross-border tax barriers

Beside double taxation treaties the further removal of tax barriers has been a topic ever since, but is - due to the associated problems regarding tax competence and sovereignty - rather a difficult and critical topic on EU level. Therefore, development regarding this topic may take more time and is rather unlikely to occur in the nearest future. In particular, there is no tax law governing the possibility to move the corporate seat of an entity within Germany to another EU jurisdiction or vice versa except for an EU stock corporation.

(iv) Strengthening supervisory convergence

With the ESMA regulation implementing an European Securities and Markets Authority a practical significant step towards a better supervisory convergence already has been made some time ago. ESMA does not only propose measures to the EU commission for implementation of EU legislation (so called level 2 measures) but also publishes guidance on interpretation of EU legislation like for instance on the EU prospectus directive. Furthermore, in practice, supervisory authorities strive for more and more co-operation and exchange of information on issuers and market practices.

**4. Have specific measures been adopted (or are foreseen) to increase choice and competition in cross-border retail financial services and/or insurance?**

As mentioned before, there have been measures to increase choice and competition in cross-border circumstances in the past. As consequence of freedom to provide services, it is possible for enterprises to offer their products wherever they want to - within the EU. Nevertheless, they have to fulfil the specific

regulations of the country they want to provide services in. Despite one European legal framework, these regulations may differ (slightly) from country to country.

An example measure would be the so-called “Passporting” (Sect. 53b KWG in German law), which - in a nutshell - allows (e.g.) a financial services provider to enter every national market with only one “passport” - meaning with only one authorization for the whole European market - while enabling the national supervising authority to perform as the host country supervision according to Sect. 53b (3) Sentence 3 KWG.

However, this only applies to EU member countries. For non-member countries these barriers are considerably higher, as it is according to Sect. 53c KWG highly dependent, if there is a financial treaty with the EU. If there is no financial treaty, a participation of such countries in that market is difficult.

**5. Capital markets harmonisation aims to facilitate companies’ access to finance, particularly for SMEs by promoting more diversified funding channels that are complementary to bank financing. Is non-bank financing significant in your country? Please consider the role of private equity, venture capital, alternative finance, loan-originating funds, etc.**

First of all, in Germany it seems, most of the companies asking banks for credit get the money they ask for. Only 13 % of the credit asking companies in Germany do not get the full amount they ask for (or nothing at all), at least EU figures state so.<sup>1</sup> In contrast, companies asking for credit in Greece do not get the amount they ask for in 67 % of the cases. However, there is no information about the reliability of these numbers and from practical experiences we assume that a significant number of enterprises, which would like to obtain credit, does not formally apply for bank credits, as they are discouraged at an earlier stage already.

Assuming these numbers are accurate, this may constitute the presumption that there may not be that much need for a non-bank financing - only in 13 % of the cases, but having a look at the types of business financing it is different (figures relate to 2010): Only 10 % of the enterprises are mainly bank financed. Most of the enterprises are either mix financed (38 %) or equity (respectively reserve) financed (35 %).<sup>2</sup>

However, the bare figures highlight the underrepresentation of venture capital compared to equity capital in financing.

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<sup>1</sup> Source: EU: Document on Capital Markets and SME in the EU, [http://ec.europa.eu/finance/capital-markets-union/docs/capital-markets-and-sme-in-eu\\_en.pdf](http://ec.europa.eu/finance/capital-markets-union/docs/capital-markets-and-sme-in-eu_en.pdf).

<sup>2</sup> Source: Deutsche Bundesbank: Presentation of 16.01.2013; Figures relate to 2010.

Venture capital transaction volume:<sup>3</sup>

2013 - EUR 720 million;

2014 - EUR 650 million;

1<sup>st</sup> quarter 2015: EUR 234 million;

Private equity transaction volume:<sup>4</sup>

2013 - EUR 40.26 billion;

2014 - EUR 40.01 billion; (EUR 10.2 billion; 2015: 15.7 billion);

1<sup>st</sup> quarter 2015: EUR 2.9 billion;

Total financing volume of non-financial companies in Germany:

2010 - EUR 400 billion<sup>5</sup>

2011 - EUR 400 billion<sup>6</sup>

2012 - EUR 380 billion<sup>7</sup>

2013 - EUR 320 billion<sup>8</sup>

Crowdfunding is a new trend in Germany like in other jurisdictions. In 2014, the volume was at EUR 140 million<sup>9</sup> with significantly increasing trend. Recently, as described above, legislation has been introduced, which resulted in a need for a prospectus for crowdfunding, if in particular the intended amount raised is higher than EUR 1 million. In addition, regardless of the amount raised, crowdfunding platforms are subject to some regulatory regulation since beginning of 2016. In particular, they need to obtain a licence and observe some compliance provisions. Already in 2015, this caused some platforms to introduce crowdfunding via issuance of debt or equity securities - as opposed to the

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<sup>3</sup> Source: Bundesverband Deutscher-Kapitalbeteiligungsgesellschaften.

<sup>4</sup> Source: Bundesverband Deutscher-Kapitalbeteiligungsgesellschaften.

<sup>5</sup> Source: Deutsche Bundesbank:

[https://www.bundesbank.de/Redaktion/DE/Downloads/Veroeffentlichungen/Monatsberichtsauftaetze/2012/2012\\_01\\_unternehmensfinanzierung.pdf?\\_\\_blob=publicationFile](https://www.bundesbank.de/Redaktion/DE/Downloads/Veroeffentlichungen/Monatsberichtsauftaetze/2012/2012_01_unternehmensfinanzierung.pdf?__blob=publicationFile)

<sup>6</sup> Source: Deutsche Bundesbank: Ergebnisse der gesamtwirtschaftlichen Finanzierungsrechnung 2008-2013

<sup>7</sup> See Fn. 6

<sup>8</sup> See Fn. 6

<sup>9</sup> Source: University of Cambridge and Ernst & Young: „Moving Mainstream” - Alternative Finance Report 2015.

“traditional” German model of subordinated loans. If a prospectus is needed anyway, the idea is to combine both worlds of crowdfunding and SME securities for investors.

Loan-originating funds do not play a significant role in Germany so far. This might change as in May 2015 BaFin, the German regulator, decided that a special AIF (alternative investment funds governed by the EU AIFM directive) does not need a banking license to grant loans.

Leasing is an important source of alternative financing in Germany with a longstanding tradition. Volume in 2014 was at EUR 59.7 billion.<sup>10</sup>

Factoring is also a common way of alternative financing in Germany. Turnovers of the members of the German Factoring Association (Deutscher Factoring-Verband e.V.) increased to EUR 189.8 billion in 2014 while the number of clients increased to 18,900. In the 1<sup>st</sup> half of 2015 the turnover went up to EUR 100.5 billion.<sup>11</sup>

**6. While loans traditionally represent the bulk of the banking assets, most financial entities also invest in capital markets. Do financial institutions in your jurisdiction invest highly in the capital markets? Are bonds and equity investments a significant proportion of the assets of financial institutions in your jurisdiction?**

There is significant investment of financial institution in capital markets in Germany as statistics evidence:

Securities portfolios of German banks by November 2015<sup>12</sup>

Bonds: EUR 1,350.9 billion

Shares: EUR 207.7 billion (including investment certificates and other securities)

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<sup>10</sup> Source: White Clark Group: Global Leasing Report 2015.

<sup>11</sup> Source: Deutscher Factoring-Verband e.V.: Jahresbericht 2014, Halbjahreszahlen 2015.

<sup>12</sup> Source: Bundesverband deutscher Banken.



- 7. Harmonisation requires standardisation, particularly in terms of credit information. Is SME credit information easily available in your jurisdiction? Is your jurisdiction adopting any measures to boost availability and standardisation of SME credit information at the national and supra-national levels?**

There are credit agencies, like Schufa (Schutzgemeinschaft für allgemeine Kreditsicherung) or Creditreform, which allow a brief credit rating for the concerning company. Such rating is subject to a charge and not standardized in Germany. Apart from that, only annual accounts are publicly available but there are no standardized credit information. The culture of German SMEs (in particular if family owned) is to keep credit information confidential.

- 8. Is there any recent or proposed legislation in your jurisdiction aimed to establish a framework for simple, transparent and standardised securitisation? Examples might include measures (i) to simplify prospectus requirements; (ii) to increase/decrease the information required to be provided to investors before making an investment decision; or (iii) to reduce barriers for smaller firms to access capital markets. If there have been no recent developments, please describe the current situation of securitisation in your jurisdiction.**

As mentioned before, there is no national legislation, but the EU proposed a securitisation regulation that will apply to all securitisations, including due diligence, risk retention and transparency rules together with criteria to identify simple, transparent and standardised ("STS") securitisations; furthermore, there is a proposal to amend the Capital Requirements Regulation (CRR) in order to make the capital treatment of securitisations for banks and investment firms more risk-sensitive and to reflect properly the specific features of STS securitisations. Accordingly, the loan securitisation, being one root of the financial crisis, gained awareness and is going to be dealt with. For example, whether loan and mortgage portfolios are transformed into tradeable securities, they have to be divided into different risk categories. Furthermore, the owner of the loans must be the owner of the securities, only loans with the same high lending standards may be packaged, no re-securitisation (no CDO-squared) is allowed and the bank has to keep at least 5% of the total amount securitised.

Additionally, as the EU published on 30.11.2015 a legislation draft to revise the directive 2003/71/EC and to amend the prospectus regime, there are remarkable changes to come. To name a few of them:

- uniform prospectus for non-equity securities listed on regulated markets (abolition of the wholesale / retail dual regime)

- universal registration document for frequent issuers on regulated markets or multilateral trading facilities
- alleviated disclosure regime for secondary issuances
- set to EUR 10 million the maximum offer consideration below which Member States may decide not to subject domestic offers to an EU prospectus
- specific disclosure regime for SMEs
- new prospectus summary modelled after the key information document
- electronic publication (centralised storage mechanism at ESMA)

To sum up the intended effects with a quote of the proposal:

*"[...] the proposed "package" will result in a reduction in the administrative burden for issuers, will make access to capital markets for SMEs easier and cheaper and improve investor protection by improving the appropriateness of the disclosure documents and ultimately enlarging choice of prospectus - based securities. This should then translate into further integration of capital markets in the Union in the form of more prospectus-based securities being offered across borders and greater transparency and comparability."*<sup>13</sup>

**9. In your experience as a banking/capital markets lawyer, have you detected in your jurisdiction any unnecessary regulatory burdens, interactions, inconsistencies and/or rules that have unintended consequences which threaten the ability of the companies to finance themselves?**

Under German law, in principle, a listed German stock corporation needs to grant its shareholders subscription rights for capital increases of more than 10% of the existing share capital. Since 2012 however, such subscription rights offering requires the publication of a prospectus due to EU legislation. Capital increases of up to EUR 5 million within a year are exempted, which only applies for issuers in the regulated market although the smaller issues are listed in the unregulated market. Due to costs connected with a prospectus, this in fact prohibits capital increases lower than (at least) EUR 1 million.

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<sup>13</sup> Source: P. 10 of the text of the EU Proposal for the Prospectus Directive:  
[http://ec.europa.eu/finance/securities/prospectus/index\\_en.htm](http://ec.europa.eu/finance/securities/prospectus/index_en.htm).

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