Investment Law – The German Small Investor Protection Act (Kleinanlegerschutzgesetz)

German Small Investor Protection Act adopted

Improved protection of small investors – facilitated access to crowdfunding

The German Small Investor Protection Act which was adopted by the Federal Assembly (Bundesrat) on June 12, 2015 and will primarily enter into force soon changes several capital market law provisions. After recent scandals which involved S&K real estate group and Prokon AG small investors require better information in order to make reasonable investment decisions and to avoid losses on the “grey capital market”. In order to achieve these objectives all investment products are subjected to a prospectus requirement. Investment product advertising is significantly limited, the German Federal Financial Supervisory Authority (BaFin) is given broader powers to sanction violations. In the future contraventions of issuers can be publicly disclosed on BaFin’s website. All investment products are subjected to fixed minimum terms and termination periods.

First of all prospectus requirements are significantly extended. Now – besides profit-participating loans (partiarische Darlehen) and subordinated loans (Nachrangdarlehen) – the distribution of any investment product which is commercially comparable to investment products under the current prospectus regime is subject to the former disclosure of a detailed prospectus. This is supposed to exclude any circumvention approaches. The minimum requirements for commercial comparability are a normal interest rate and a repayment claim.

Issuers must provide their prospectus to BaFin. Before its publication BaFin reviews the prospectus with respect to completeness and comprehensibility. In the future any investment product prospectuses and any supplements must also be made available to investors online, i.e. on an internet website. Every 12 months the prospectus must be updated and submitted to BaFin for a repeated review. Even after the offer’s end issuers must disclose facts which could impair the proper repayment to investors on their website and to BaFin.

Exceptions from the prospectus requirement apply to crowdfunding and commission free distribution in connection with social projects if the total investment amount does not exceed € 2.5 million. However, these investment products are subject to a 14-day right of withdrawal and allow for single investment amounts of more than € 10,000.

Investment product advertising is significantly limited. Billboard advertising, e.g. in busses and subways and direct mails are prohibited. Comparable to cigarette advertisement newspaper and electronic media ads must include warning notices mentioning the risk of total loss. However, a hyperlink referring to the
warning notice will be sufficient. Using other media for advertisement is only permitted if such media report about economic issues “at least from time to time”. This requirement is supposed to ensure that the advertisement is directed at persons who are willing to adopt economic information and who will gather additional information if necessary. Overall the act is supposed to promote risk awareness with respect to the making of investment decisions.

In the future BaFin will be allowed to publish issuers’ contraventions against legal provisions including the issuer’s name on its website. This measure is expected to have a disciplinary effect because issuers with a negative record will find it difficult to convince investors. Apart from that BaFin may still limit the marketing of investment products or prohibit their distribution if there are significant concerns regarding investor protection or dangers regarding market function and market integrity.

Subject to concrete indications for contraventions BaFin may order the external auditing of issuers’ accounts. In addition the administrative fines for delayed publications of annual statements are significantly increased from € 25,000 to € 250,000. While issuers have so far neglected the publication of annual statements due to the low penalties it is expected that given the increase of the administrative fines issuers will comply with the publication deadlines in the future.

Finally, investment products are subjected to a minimum term of 24 months and a termination period of at least 6 months. This is supposed to create a stable calculation basis for investors and the awareness that an investment product is a business investment for a certain period of time.

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