

BaFin Report Provides Guidance on Application of New Regulation on PIBs

On December 5, 2011, the German Financial Supervisory Authority (BaFin) issued a report on the results of its analysis of 120–130 product information sheets. The report provides valuable guidance regarding the necessary and permissible content of the product information sheets.

The Act to Strengthen Investor Protection and to Improve the Operability of the Capital Market (*AnsFuG*), which came into effect April 8, 2011, has introduced product information sheets (*Produktinformationsblätter – PIBs*) to Germany.

Designed to protect retail investors from information overload, PIBs are meant to contain a basic description of the financial instrument in a short (two-to-three page) and easy to understand manner. Investment advisors are required, pursuant to sec. 31 para 3a of the German Securities Trading Act (*WpHG*) (the "Regulation"), to provide a PIB to retail investors, with respect to every financial instrument the investment advisors recommend for purchase by such investors. The PIB must set out the essential information regarding the financial instrument, including the type of financial instrument (e.g., securities, derivatives, money market instruments and rights to subscribe for securities), its functionality, the related risks, the chances of repayment of capital under different market conditions and the associated costs. The purpose of the obligation to provide a PIB is to enable the retail investor to more easily compare different financial instruments, and to make an informed decision based on the key facts regarding such financial instrument.

The competent authority for the supervision of PIBs' compliance with the provisions of the Regulation, is the German Financial Supervisory Authority (*Bundesanstalt für*

Finanzdienstleistungsaufsicht – BaFin). On December 5, 2011, BaFin released a report (the "Report") analyzing the quality of 120-130 PIBs that had been issued during the first five months of the new regulation. The Report is a follow-up to BaFin circular 6/2011, in which BaFin announced that it would monitor and analyze the initial PIBs issued, in order to ensure the comparability of such PIBs and their compliance with the Regulation.

The Regulation does not itself provide detailed definitions or specific implementation guidance. Such information is only partly set forth in sec. 5a of the Investment Services Conduct of Business and Organisation Regulation. Although the German Ministry of Finance (*Bundesfinanzministerium*) is authorized to adopt statutory regulations regarding the implementation of the PIB requirements, such regulations have not been adopted to date. In the meantime, BaFin may promulgate rules regarding any open issues. Thus, the findings of BaFin in the Report provide important guidance for the production of PIBs.

Key Findings of BaFin

The Report starts by noting that the majority of the analyzed PIBs comply with the length limits. It also welcomes the fact that most PIBs are presented in a format that conforms to the standard template of the German Banking Industry Committee (*Deutsche Kreditwirtschaft*).

The Report then addresses five major issues that have been presented with respect to the PIBs.

Lack of Disclosure Tailored to Financial Instrument Being Offered

Pursuant to the Regulation, the PIB must contain the requisite disclosures for the particular financial instrument (*Finanzinstrument*) being offered. However, some of the analyzed PIBs were directed only to the relevant type of financial instruments (e.g., stocks in general rather than the specific XY stock).

Some PIBs did not comply with the requirements regarding the presentation of fees and expenses. For example, references to a schedule of prices, or to detailed information that must be requested from the investment advisor, are not compliant with the requirements and must be avoided. The same is true for abstract statements in the form of costs that may be “incurred as a rule” or “can be up to” a certain amount. According to BaFin, the actual costs must be stated in absolute numbers or in terms of a percentage of the amount to be invested. Abstract statements are only permissible with regard to stock exchange fees and custodian fees or the like.

Another issue, according to BaFin, is the boilerplate disclosure of risk factors. BaFin found that many PIBs listed as many risk factors as possible with regard to a certain type of financial instrument, although some of the risks might not have existed in the actual case (e.g., description of currency exposure risk with regard to a bond of a German issuer denominated in Euro).

Other PIBs did not address certain important risk factors, such as the risk of a total loss. According to BaFin the following risk factors should be discussed, where such risk is inherent in a financial instrument:

- counterparty risk;
- securities price/interest rate risk;
- dividend risk; and
- risk of a total loss.

With regard to certificates or bonds with interest returns that depend on the certificate's/bond's market value meeting, exceeding or falling below certain barriers/thresholds, BaFin expects such barriers/thresholds to be explicitly stated and explained. While an abstract reference regarding such barriers/thresholds may be acceptable in the

product description, detailed and specific explanations as to the nature of the risk and any trigger events must be included in the risk factors.

Finally, BaFin criticizes shortcomings regarding the product description in many PIBs. BaFin requires a discussion of certain minimum details regarding each financial instrument (e.g., the class of business or industry sector of the issuer of shares), as well as reference to the website of the underlying or issuing company. In case of governmental bonds, the issuing government must be named. BaFin suggests the use of graphs or charts to help retail investors to understand the risks more easily.

Lack of Comprehensibility

BaFin objects to the use of descriptive terms and explanations that are hard to understand for the “average” retail investor. BaFin explicitly refers, for example, to unexplained technical terms, complicated and long sentences and unfamiliar abbreviations (e.g., “Day count fraction: ACT/ACT”, “Stock exchange listing: EUROMTF”, “Settlement currency: NOK”).

Furthermore, BaFin objects to presentations of performance that are not based on the net performance of the particular financial instrument. In accordance with BaFin's circular 4/2010¹ (*MaComp*), it is sufficient to provide a sample calculation based on an investment amount of Euro 1,000 and a time period of five years (unless the maturity date is earlier, in which case the calculation should use the relevant time period). It is necessary to update the sample calculation in the case of material changes or events (e.g., if a certificate hits a knock-out threshold).

Exceeding Length Limits

Although this does not seem to be a widespread problem according to the Report, BaFin expressly mentions this as an issue it will track. BaFin indicates that it will issue formal complaints by written notice to issuers of PIBs who do not comply with the length restrictions.

¹ Minimum Requirements for the Compliance Function and Additional Requirements Governing Rules of Conduct, Organisation and Transparency pursuant to Sections 31 et seq. of the Securities Trading Act (*Wertpapierhandelsgesetz - WpHG*) for Investment Services Enterprises.

Inadequate Discussion of Required Information

The Report criticizes shortcomings in the discussion of important information. Commonly missing information includes, *inter alia*:

- the specific assumptions underlying different scenarios (BaFin requires the use of assumptions that provide for stable, sinking or rising prices/interest rates under different scenarios);
- information regarding the duration/time period of a financial instrument (e.g., maturity date or the date of a special right of termination of the issuer);
- the date of print of the PIB to evaluate whether its information is current;
- in certain instances, information regarding market values or rates of return. (BaFin indicates that market value data need not be included in the PIB if such value is subject to fluctuations or if the financial instrument is purchased on a secondary market. However, during the subscription phase of a new issue, the fixed price needs to be stated as well as the rate of return.)

Impermissible Statements

BaFin indicates that the PIB may not include statements pertaining to:

- exclusion of liability for the accuracy of information in the PIB; and
- ratings (since there is not a rating for each financial instrument, such rating may be deemed promotional information that is generally not acceptable in PIBs).

Consequences of BaFin Regarding Serious Infringements

BaFin has announced that it will make a formal complaint by written notice to the respective issuers of the PIBs in case of the following serious infringements:

- discussion of only generic financial instruments rather than specific financial instrument being offered;
- inadequate presentation of fees and costs;

- exceeding of length limits; and
- exclusion of liability with respect to accuracy of information.

Conclusion

The Report provides valuable guidance regarding the necessary and permissible content, as well as the format, of PIBs under the Regulation. By pointing out infringements, impermissible statements and shortcomings of existing PIBs, BaFin sharpens the regulatory framework and facilitates the preparation of new PIBs by issuers. By reference to BaFin's catalogue of "serious infringements" it becomes clear which provisions require particular attention.

It remains to be seen whether the monitoring and analysis by BaFin will result in another Report in the future or if the German Ministry of Finance will issue a statutory ordinance to provide further specifications. Until then, the statutory law in conjunction with BaFin's circular 4/2010 and the Report provide sufficient guidance for the preparation of PIBs under the Regulation.

■ ■ ■

This update was authored by Angelo Lercara (+49 89 21 21 63 22; angelo.lercara@dechert.com) and Robert Eberius (+49 89 2121 6341; robert.eberius@dechert.com).

Practice group contacts

For more information, please contact the author, one of the attorneys listed, or any Dechert attorney with whom you regularly work. Visit us at www.dechert.com/financial_services.

Sign up to receive our other [DechertOnPoints](#).

Karen L. Anderberg

London
+44 20 7184 7313
karen.anderberg@dechert.com

Peter D. Astleford

London
+44 20 7184 7860
peter.astleford@dechert.com

Gus Black

London
+44 20 7184 7380
gus.black@dechert.com

Martin Day

London
+44 20 7184 7565
martin.day@dechert.com

Peter Draper

London
+44 20 7184 7614
peter.draper@dechert.com

Olivier Dumas

Paris
+33 1 57 57 80 09
olivier.dumas@dechert.com

Richard Frase

London
+44 20 7184 7692
richard.frase@dechert.com

John Gordon

London
+44 20 7184 7524
john.gordon@dechert.com

Andrew Hougie

London
+44 20 7184 7373
andrew.hougie@dechert.com

Angelo Lercara, LL.M. EuR

Munich
+49 89 21 21 63 22
angelo.lercara@dechert.com

Angelyn Lim

Hong Kong
+852 3518 4718
angelyn.lim@dechert.com

Stuart Martin

London
+44 20 7184 7542
stuart.martin@dechert.com

Michelle Moran

Dublin
+353 1 436 8511
michelle.moran@dechert.com

Antonios Nezeritis

Luxembourg
+352 45 62 62 27
antonios.nezeritis@dechert.com

Declan O'Sullivan

Dublin
+353 1 436 8510
declan.osullivan@dechert.com

Achim Pütz

Munich
+49 89 21 21 63 34
achim.puetz@dechert.com

Marc Seimetz

Luxembourg
+352 45 62 62 23
marc.seimetz@dechert.com

Hans Stamm

Munich
+49 89 21 21 63 42
hans.stamm@dechert.com

James M. Waddington

London
+44 20 7184 7645
james.waddington@dechert.com

Jennifer Wood

London
+44 20 7184 7403
jennifer.wood@dechert.com

Dechert internationally is a combination of limited liability partnerships and other entities registered in different jurisdictions. Dechert has more than 800 qualified lawyers and 700 staff members in its offices in Belgium, China, France, Germany, Hong Kong, Ireland, Luxembourg, Russia, the UK, and the US.

Dechert LLP is a limited liability partnership registered in England & Wales (Registered No. OC306029) and is regulated by the Solicitors Regulation Authority. The registered address is 160 Queen Victoria Street, London EC4V 4QQ, UK.

A list of names of the members of Dechert LLP (who are referred to as "partners") is available for inspection at the above address. The partners are solicitors or registered foreign lawyers. The use of the term "partners" should not be construed as indicating that the members of Dechert LLP are carrying on business in partnership for the purpose of the Partnership Act 1890.

Dechert (Paris) LLP is a limited liability partnership registered in England and Wales (Registered No. OC332363), governed by the Solicitors Regulation Authority, and registered with the French Bar pursuant to Directive 98/5/CE. A list of the names of the members of Dechert (Paris) LLP (who are solicitors or registered foreign lawyers) is available for inspection at our Paris office at 32 rue de Monceau, 75008 Paris, France, and at our registered office at 160 Queen Victoria Street, London, EC4V 4QQ, UK.

Dechert in Hong Kong is a Hong Kong partnership regulated by the Law Society of Hong Kong.

This document is a basic summary of legal issues. It should not be relied upon as an authoritative statement of the law. You should obtain detailed legal advice before taking action. This publication, provided by Dechert LLP as a general informational service, may be considered attorney advertising in some jurisdictions. Prior results do not guarantee a similar outcome.

Dechert in Ireland is an Irish partnership regulated by the Law Society of Ireland.

© 2011 Dechert LLP. Reproduction of items from this document is permitted provided you clearly acknowledge Dechert LLP as the source.

EUROPE Brussels • Dublin • London • Luxembourg • Moscow • Munich • Paris • **U.S.** Austin
Boston • Charlotte • Hartford • Los Angeles • New York • Orange County • Philadelphia
Princeton • San Francisco • Silicon Valley • Washington, D.C. • **ASIA** Beijing • Hong Kong