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German Tax and Legal News

German Government Draft Bill to Amend the Stock Corporation Act

A new try – the German Government presents a draft bill to amend the AktG. We inform you about the main topics of the draft bill.

The bill for an amendment of the German Stock Corporation Act (Aktiengesetz – AktG) was already passed in the Bundestag (lower house of the German parliament) 2012 in the last legislative period. After the Bundestag had passed it, the Bundesrat (upper house of the German parliament) referred the matter to the mediation committee due to resistance to some of the regulations included in the bill such as the introduction of public supervisory board meetings in companies with shares held by public institutions, the widespread replacement of bearer shares and the proposal for "decide on pay" – and the legislation was left unfinished due to the Bundestag elections which then followed.

The current bill to amend the Stock Corporation Act which the German government has now proposed avoids regulations on the political mine fields mentioned above and instead only envisages some minor further developments of a few points of the Stock Corporation Act. The Bundesrat has now also issued a statement on the bill which is generally worded positively but also includes critical comments on individual regulations and identifies a need for alterations.

I. Main Issues of the Bill and Criticism

1. Restricting Voting Rights of Share Types for Non-Listed Companies

New regulations in Stock Corporation Act are intended to make the distribution of ownership more transparent for non listed stock corporations particularly in order to combat money laundering and the financing of terrorism. Pursuant to the hitherto regulation both listed and non-listed stock corporations could choose between bearer and registered shares. While stock exchange rules already stipulate that the shares must be securitized in at least one global share certificate for listed stock corporations and individual certificates are generally prohibited, a non-listed company can refrain from securitizing the shares, or the shares can be securitized in global, multiple or individual share certificates which can also be kept physically by the shareholders or by the company in the case of global share certificates. Furthermore keeping a share register is currently only foreseen if securitized registered shares are issued. The shareholder structure is therefore not transparent for non-listed stock corporations which issue bearer shares or registered shares which are not securitized at least as far as the holdings are below the statutory notification thresholds (lowest notification threshold: 25 %).

The proposed new regulation foresees registered shares as standard for listed and non-listed stock corporations. It is also clarifies that a securitization of registered shares does not constitute a precondition for the obligation to keep a share register. Bearer shares may only be issued if the stock corporation is listed (since the company is then subject to the strict regulations in capital market law to publish holdings; lowest notification threshold: 3 %) or the claim by a shareholder to individual securitization is excluded (currently the standard case) and the global share certificate is deposited with a bank acting as a central depository of securities (Clearstream Banking AG in Germany) or a comparable foreign depository.

Compared with limited liability companies (Gesellschaft mit beschränkter Haftung – GmbH) where the shareholder list which is available for anyone to view publishes the identity of the shareholders, the new regulations still do not allow for full transparency with respect to stock corporations. Although investigative authorities combatting money laundering can investigate the shareholders via the bank acting as a central depository of securities for non listed stock corporations which have issued bearer shares where individual securitization is no longer possible, this does not achieve the desired full transparency of the shareholders' identity.

Already existing companies which have issued bearer shares are not affected by the above new regulations due to a broad regulation on the right of the status quo to continue. Modifications are not foreseen for listed companies either.

2. Introduction of a Record Date for Registered Shares
A standard record date is to be introduced for registered and bearer shares. Such a record date has not hitherto been envisaged for determining the shareholders with registered shares who are entitled to participate and vote in the annual general meeting (AGM). This record date will now be stipulated at 21 days before the AGM in order to match the existing legal situation for bearer shares of listed stock corporations.

In practice entries of registered shares in the share register had previously been suspended for a limited period before the AGM in order to insure that the entitlement to participate and vote at the AGM was determined reliably. Although the new regulation will also create a plausible and legally compliant basis for registered shares, the Bundesrat correctly criticized in its statement on the bill the same record date for both bearer and registered shares since it does not take account of the particularities of registered shares. While holders of bearer shares are informed by their depository bank about the AGM, the holders of registered shares are informed by the stock corporation itself. Consequently there is no need in the case of registered shares to separate determining the entitlement to participate and vote in the AGM from the registration in the share register by introducing a record date long before the actual meeting. Although legal certainty is created by the regulation, the time for making an entry in the register is made much shorter which is especially disadvantageous for foreign shareholders who wish to exercise their rights at the AGM, which was exactly what the new regulation should attempt to improve.

Although it is foreseeable that the legislation will therefore also include a record date for registered shares, the exact specification of the record date remains rather vague. The Deutsches Aktieninstitut (German share market institute) proposes stipulating the record date on the 10th/12th day before the AGM in order to take account of the particularities of registered shares. This certainly appears appropriate.

3. Creating Core Capital through Preference Shares
In order to make the financing of stock corporations more flexible, the proposed bill to modify the Stock Corporation Act foresees regulations where regulatory core capital can also be raised by issuing non voting preference shares. Under the previous legal situation the preference was understood as an advance dividend which was mandatorily payable on a cumulative basis. This was particularly disadvantageous for credit institutes since such preference shares were not recognized as regulatory core capital pursuant to applicable EU law (Capital Requirement Regulation).

In order to make it easier for stock corporations in general to raise capital and for credit institutes in particular to raise core capital it will now also be possible to issue preference shares with a non cumulative entitlement if the articles of association are modified accordingly. Furthermore it is clarified that in future the preference (either payable on a cumulative basis or with a non-cumulative entitlement) can in particular be a share in the profit which is allocated to the shares in advance (so called advance dividend) or an additional share in the profit (so-called additional dividend). It should also be noted that if the preference dividend is not paid (in full), the voting right applies temporarily, i.e. until the preference is paid again.

It is generally to be welcomed that the preference share is made more flexible, but it is not certain and certainly controversially discussed in the legal literature whether the new regulation permits it to be recognized as regulatory core capital. However, since it is possible to eliminate the concerns by legal modifications, it must be assumed that the corresponding regulations will generally be implemented.

4. Permitting Reverse Convertibles
The proposed regulation for a “reverse convertible” also has an effect on financing stock corporations. While convertibles grant the creditor with a conversion option, with which the creditor can convert the bond into a share, reverse convertibles grant the stock corporation as the share debtor the option of conversion. Furthermore such reverse convertibles can also be permitted as conditional capital. While convertibles are only generally permitted as conditional capital up to 50 % of the share capital, the new regulation will make an exception for reverse convertibles in order to prevent insolvency. This is a type of “reserved debt equity swap” in the event of a crisis.

Securing reverse convertibles in legislation is to be welcomed since it increases the level of flexibility for financing the company and creates legal certainty. It was hitherto only possible

to achieve the same effect using a mandatory convertible of the company with a cash compensation option. The company is also given satisfactory means to combat a crisis with the exemption regulation of the “reserved debt equity swap”.

5. Adjustments Regarding Legal Action
In contrast with the amendment of the Stock Corporation Act in 2012 where it was originally foreseen, the bill does not include an extensive reform of rescission suits; however, there is a regulation with an individual correction regarding a relative time period for subsequently submitted pleas for annulment. The aim of the new regulation is to prevent exploitation of subsequently submitted pleas for annulment which are filed in order either to prevent a successful application by the company for release or to participate in the foreseeable financial success of a rescission suit. In order to achieve this, it should only be possible to submit such a plea for annulment within one month following disclosure of the initial legal suit.

II. Assessment
The new regulations to amend the Stock Corporation Act certainly offer sensible clarification and modification. The regulations do not extensively modernize stock corporation law, however; instead it appears that they are selective adjustments which will not generate any significant political resistance. It is therefore expected that the bill will be passed in 2015. The new regulations should therefore already be taken into consideration when planning measures under stock corporation law.
