

February 6, 2012

## New German Long and Short Disclosure Regimes

### I. New German Long Disclosure Regime

As of February 1, 2012, the German voting right disclosure rules set forth in the German Securities Trading Act (*Wertpapierhandelsgesetz – WpHG*) will be significantly extended to financial instruments and other instruments, which (directly or indirectly) enable (*ermöglichen*) the holder or third parties to acquire ordinary (voting) shares that are German listed securities.

#### Transparency for cash-settled instruments

The newly created Sec. 25a WpHG extends the notification obligations to all financial instruments and other instruments (including also indirect holdings, *e.g.*, through a subsidiary or a trustee) that merely enable – instead of legally entitle – the holder to acquire voting rights. An enabling right shall in particular exist if (i) the counterparty to the transaction could exclude or reduce risks arising from these instruments by holding shares, irrespective of whether they actually hedge such risks in the specific case, or (ii) the instruments grant a right or create an obligation to acquire shares.

Sec. 25a WpHG will therefore cover, in particular, financial contracts for difference, swaps (even cash-settled equity swaps), cash-settled call options, put options and other transactions that have the economic consequence of enabling the acquisition of voting rights, including, for example, the right to the return of securities that have been the subject of a right of use (rehypothecation).

The number of voting rights to be notified shall correspond to the number of voting rights, the owner or a third party is able to acquire with the instrument. If the instrument does not contain such information, the number of voting rights to be notified shall equal the number of shares which the counterparty would have to hold to fully hedge the instrument assuming a delta value of one (1) (*i.e.*, no delta adjustment).

The first notification threshold is set at 5% (the subsequent relevant thresholds are 10, 15, 20, 25, 30, 50, and 75%). Any voting rights pursuant to Sec. 21, 22 WpHG and (hypothetical) voting rights in connection with instruments pursuant to Sec. 25 WpHG (*i.e.*, financial and other instruments which *entitle* the holder to acquire shares with voting rights) will have to be aggregated with voting rights pursuant to Sec. 25a WpHG. However, the respective percentages of the three different "baskets" will have to be disclosed separately.

Financial and other instruments held by financial institutions which have their seat in the European Union or in the European Economic Area and which issue in their ordinary business to a large number of customers such financial and other instruments are exempted from the notification obligation.

Financial and other instruments within the meaning of Sec. 25a WpHG existing as of February 1, 2012 must be notified without undue delay, and in any event within 30 trading days (*i.e.*, by March 13, 2012) (Sec. 41 para. 4d WpHG). Non-compliance with this status notification obligation (*Bestandsmitteilungspflicht*) may result in a fine of up to EUR 200,000. Apart from this, a violation of the new disclosure regime for financial and other instruments may result in a fine of up to EUR 1,000,000. BaFin may even increase the fine and confiscate (*abschöpfen*) the profits of the illegal transaction.

On January 30, 2012, BaFin published its regulation setting forth only two (limited) exemptions for instruments relating to own shares of the issuer of such shares as well as baskets and indices. In addition, in January 2012, the German Financial Supervisory Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht – BaFin*) published FAQs and new standard notification forms related to the new disclosure regime set forth in Sec. 25 and 25a WpHG.

## Transparency in case of "return rights"

In future, the modified notification obligations in Sec. 25 WpHG will also cover all agreements granting the right to acquire ordinary (voting) shares, *e.g.*, return rights of the lender in case of securities lending, repurchase claims in case of so-called repo transactions (sale of securities together with an agreement to buy back the securities at a later date), and other forms of return rights, including the rights to the return of securities that have been the subject of a right of use (rehypothecation). A notification requirement is also triggered if the aggregation with actual shareholdings that must be disclosed under Sec. 21 *et seq.* WpHG leads to the crossing of a threshold which has already been notified. The initial disclosure threshold for other instruments remains set at 5% (the subsequent relevant thresholds are 10, 15, 20, 25, 30, 50, and 75%).

In contrast to instruments covered by Sec. 25a WpHG, there is no obligation to make status notifications (*Bestandsmitteilungen*) of existing holdings of other instruments within the meaning of Sec. 25 WpHG held as of February 1, 2012. Nevertheless, a *de facto* status notification obligation (*Bestandsmitteilungspflicht*) might be indirectly triggered through the status notification obligation (*Bestandsmitteilungspflicht*) related to Sec. 25a WpHG as any voting rights pursuant to Sec. 21, 22 WpHG and positions pursuant to Sec. 25 WpHG will have to be aggregated with voting rights pursuant to Sec. 25a WpHG.

## II. New German Short Disclosure Regime

As of March 26, 2012, new statutory notification and publication requirements for net short-selling positions in all financial instruments admitted to trading on a German regulated market will come into force (Sec. 30i WpHG).

Previously, only net short-selling positions in shares of ten explicitly named companies in the financial sector had to be notified to BaFin.

According to Sec. 30i para. 2 WpHG, a net short-selling position shall be deemed to exist when – after netting all financial instruments (*e.g.*, including options, futures and swaps) of a holder – the holder's economic exposure in the company's issued shares (*i.e.*, ordinary shares and preference shares without voting rights, if any) is equivalent to a short-selling position in shares. Please note that the calculation of the net short-selling position and the disclosure must be done on a holder by holder basis, *i.e.*, there is no netting and aggregation of positions within a group.

For purposes of calculation of the net short-selling position, the financial instruments must – other than in case of Sec. 25a WpHG (see above) – be included on a delta adjusted basis. If the net short-selling position reaches, exceeds or falls below the specified thresholds merely because of the change in the delta for the aggregate net short-selling position, a notification and, if applicable, publication is nevertheless required.

Sec. 30i WpHG provides for a two-tier transparency system. Holders whose net short-selling positions reach, exceed or fall below 0.2% of the company's issued shares (rounded to the nearest hundredth of a percent) will be required to notify BaFin (Sec. 30i para. 1 sent. 1 WpHG). In addition, market participants with net short-selling positions that reach, exceed or fall below 0.5% of the company's issued shares must publish such positions in the German Electronic Federal Gazette (*elektronischer Bundesanzeiger*) (Sec. 30i para. 1 sent. 2 WpHG). If the net short-selling position reaches, exceeds or falls below the threshold of 0.2.% (or, as the case may be, 0.5%) by a further 0.1%, additional notifications and/or publications are required.

According to BaFin's draft regulation (*Netto-Leerverkaufstransparenzverordnung – N-LPTVO*) for a more detailed definition of the obligations laid down in Sec. 30i WpHG, BaFin will set up a new electronic notification and publication procedure (*Melde- und Veröffentlichungsplattform – MVP*) which shall be available at the beginning of March 2012. The notifier (or a third party appointed by the notifier, as the case may be) will have to register for this electronic notification and publication procedure as well as for the specific procedure "net short-selling positions". In addition, at the latest upon submission of the first notification, each notifier and each contact person of a notifier will have to provide for documentation required for a clear identification of the notifier or the contact person. In view of the large number of notifiers expected, BaFin will provide for a respective pre-registration possibility (without making a notification) and recommends to use this opportunity. BaFin will publish information on the pre-registration possibility as soon as it is available.

The information to be published in the German Electronic Federal Gazette (*elektronischer Bundesanzeiger*) shall be submitted by the notifier to the German Electronic Federal Gazette (*elektronischer Bundesanzeiger*) (i) in a form to be provided by the German Electronic Federal Gazette (*elektronischer Bundesanzeiger*) or (ii) by way of upload in XML-format. However, the respective forms and formats are not available yet.

The draft regulation provides further guidance in respect of the calculation of net short-selling positions, the technical notification and publication procedure as well as related requirements. BaFin intends to publish standard notification forms before March 26, 2012.

Net short-selling positions must be notified and, where applicable, also published by the end of the next trading day after they arise. It is not necessary to notify and publish thresholds that are reached or crossed within a single trading day. Only the net short-selling position at the end of the respective trading day determines whether there is a notification obligation.

Net short positions held by an investment services company or similar company are exempt from these disclosure requirements, if and to the extent such company is located abroad and (i) trades the respective shares for its own account (*Eigenhandel*) and offers on a regular and continuous basis to purchase or sell these at prices defined by such company, or (ii) fulfills customer orders and hedges the resulting positions, on a regular and continuous basis. In each case, the respective underlying transaction must be necessary for the performance of such activity.

Net short positions within the meaning of Sec. 30i WpHG existing as of March 26, 2012 must be notified and, where applicable, also published by the end of the next trading day (*i.e.*, by March 27, 2012). Violations of the notification and publication requirement for net short-selling positions are punishable by fines of up to EUR 200,000.

Sec. 30i WpHG will only apply for approximately seven months as the European regulation on short selling and certain aspects of Credit Default Swaps (CDS) shall come into force on November 1, 2012. The provisions in the European regulation will go beyond the German short disclosure regime and extend the notification and publication obligations, *inter alia*, to all shares admitted to trading on European markets, including shares traded on a multilateral trading-facility (MTF) and an over-the-counter market (OTC).

### III. Practical Implications

Apart from the relatively obvious implications of these new disclosure regimes, investors in German listed securities will need to consider how custody and prime brokerage arrangements, which may allow rights of use and/or borrowing of such securities, can be managed in light of these new regimes.

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This publication is intended only as a general discussion of these issues. It should not be regarded as legal advice. We would be pleased to provide additional details or advice about specific situations if desired.

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