CLIFFORD CHANCE

Client briefing
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Germany imposes transparency rules on short positions in financial stocks

The Federal Financial Services Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht) (BaFin) has announced new short position reporting requirements for ten leading German financial stocks, effective on 25 March 2010. The new rules require an investor to notify net short positions of 0.2% or more to BaFin and for BaFin to publish an anonymised version of the report to the market where the net short position is 0.5% or more. There is a limited exemption for certain market makers but the new rules differ in many respects from those recently recommended by the Committee for European Securities Regulators (CESR). The Federal Ministry of Finance (Bundesfinanzministerium) (BMF) has also announced its intention to propose legislation banning naked short selling.

Key Issues

Investors must disclose net short positions in ten German financial stocks

Private disclosure to BaFin of net short positions of 0.2% or more (on T+1)

Anonymised public disclosure by BaFin of net short positions of 0.5% threshold

Additional disclosures at 0.1% increments above these thresholds (and when net short position reduced below these thresholds)

Limited exemption for market makers

New rules effective on 25 March 2010 (until 31 January 2011)

Disclosure obligation

An investor that has a net short position which reaches, exceeds or falls below 0.2 % of the issued shares of one of the specified companies must notify BaFin of the short position (rounded to two decimal places) by the end of the next trading day (i.e. T+1).

An investor must also publish, in anonymised form, any net short positions in the specified stocks that reach, exceed or fall below a threshold of 0.5 % (again rounded to two decimal places). For this purpose, the investor must communicate its net short position (again rounded to two decimal places) to BaFin within one trading day, at the same time as it notifies BaFin as indicated above. BaFin will then publish the net short positions on its website within a further trading day (i.e. T+2).

An investor is required to make further notifications to BaFin when the level of its net short position exceeds the above thresholds by a further 0.1 % (e.g. 0.3 %, 0.4 %, 0.5 %, 0.6 % etc.) or reaches or falls below those 0.1% incremental thresholds.

On the effective date of the new rules, an investor must notify BaFin in the manner contemplated above if it has a net short position in excess of 0.2% or 0.5% in the specified stocks.

Calculation and exemptions

For these purposes, an investor will be considered to have a net short position when a netting of all positions in financial instruments it holds results in the investor's aggregate economic interest in the company's issued shares corresponding to a short position in shares. The holder of the net short position is the natural or legal person or investment fund (Sondervermögen) that holds the netted financial instruments. An investment manager is required to make the notifications for each investment fund managed by it separately (i.e. there is no aggregation or netting between funds if an investment manager acts for several funds).

The obligation to notify arises at the point when the investor knows or ought to have known that the level of its net short position has reached, exceeded or fallen below the thresholds. BaFin has published forms to be used for the purpose of making the notifications.

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There is a limited exemption for a narrowly defined class of market makers, i.e. persons who have contractually undertaken to purchase or sell financial instruments on a continuous basis by way of trading for own account at prices defined by them (to the extent that the respective transaction is necessary for the performance of such contractual obligations).

Legal powers

BaFin's decree is based on general powers under the German Securities Trading Act (Wertpapierhandelsgesetz) empowering BaFin to make orders to counteract undesirable developments which may adversely affect the orderly conduct of trading in financial instruments or the provision of investment services or ancillary services or which may result in serious disadvantages for the financial market. According to the answers to frequently asked questions (FAQs) published by BaFin it appears that BaFin intends that its new rules will apply extra-territorially, but the territorial scope of the new requirements and the sanctions for contravention are not entirely clear. To the extent any such activities give rise to market manipulation the German market abuse provisions will apply extra-territorially and there will be sanctions under the German Securities Trading Act. In any event, the decree states that the new rules will lapse on 31 January 2011.

Nevertheless, the BMF has recently presented plans for a German Act to Strengthen Investor Protection and Enhance Functionality of the Capital Market (Gesetzesentwurf zur Stärkung des Anlegerschutzes und Verbesserung der Funktionsfähigkeit des Kapitalmarktes). The plans indicate that there will be legislative proposals to ban naked short-selling, to create a statutory framework for regulatory transparency rules covering all shares traded on a regulated market and to provide for effective sanctions to ensure the enforcement of reporting requirements.

Mismatch with CESR proposals

BaFin's decree was published only days after CESR published its advice to the European Commission recommending the creation of a harmonised pan-European disclosure system for net short positions. That advice had recognised the possibility that individual CESR members might act in advance of any EU legislation to implement the CESR recommendations. Indeed, some of the features of BaFin's rules correspond to CESR's advice, in particular the 0.2% and 0.5% thresholds for private and public disclosure of net short positions and the T+1 timeframe for notifying regulators of net short positions.

However, BaFin's rules are limited to specified financial stocks, whereas CESR's advice recommended covering all shares traded on regulated markets or multilateral trading facilities in the EU (unless the primary market for the shares is outside the EU). In addition, BaFin's exemption for market-makers is much narrower than CESR's recommended exemption, which would cover a much broader category of liquidity providers, and BaFin's rules on aggregation and netting for investment fund managers seem to differ significantly from CESR's proposals.

Even more importantly, BaFin's rules only require anonymised public disclosure at the 0.5% threshold (effectively on T+2). CESR had specifically recommended that the public disclosures (on T+1) should identify the investor holding the net short position, notwithstanding the significant concern of many market participants about the adverse impact on markets and market users of publicly identifying investors who hold net short positions (and the recent evidence published showing the adverse effects of such disclosure requirements in the UK). In contrast, the recent proposals from the Hong Kong Securities and Futures Commission (SFC) envisage weekly reporting to the SFC of short positions of 0.02% or HK$30 million (whichever is the lower) in certain major stocks but the SFC will then publicly disclose those positions only on an aggregated and anonymised basis.

*BaFin's decree is available **here** and its answers to FAQs are available **here**.*

The following shares are covered by the new rules: Aareal Bank AG, Allianz SE, Generali Deutschland Holding AG, Commerzbank AG, Deutsche Bank AG,Deutsche Börse AG, Deutsche Postbank AG, Hannover Rückversicherung AG, MLP AG, Münchener Rückversicherungs-Gesellschaft AG