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Germany Tightens Voting Rights Disclosure Regime

New rules increase complexity of voting right disclosures and impose drastic sanctions

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On October 1, 2015, the German Parliament adopted the national “Act Implementing the EU Transparency Directive Amending Directive (2013/50/EU)” (the “**Act**”). The aim of the directive is to harmonize the regime for notification of major holdings and to improve compliance throughout the EU. Germany exercised its discretion under the amending directive and implemented comparatively strict rules that will further increase the complexity of Germany’s disclosure regime. Investors will have to comply with the disclosure regime if they are direct or indirect shareholders of, or hold financial instruments relating to, issuers whose home member state is Germany and whose shares are admitted to trading on a regulated market (e.g. the General or Prime Standard of the Frankfurt Stock Exchange). It will come into force immediately following its promulgation, which is imminent.

Key takeaways:

- Notification period to start on the trading rather than the settlement day.
- Ongoing monitoring obligations regarding issuers’ outstanding shares.
- Cash-settled instruments to be notified on a delta-adjusted basis, requiring constant monitoring of changes in the delta.
- Drastically increased fines and extended loss of shareholder rights.
- Naming and shaming—administrative sanctions will be made public.
- Status notifications for financial instruments greater than 5% due by mid-January 2016.

Earlier deadline for notifications of major shareholdings

Upon reaching or crossing a voting rights threshold (starting at 3%), the relevant holder of shares or other relevant instruments must notify both the issuer and the German Federal Financial Supervisory Authority (“**BaFin**”) of its new holding within four trading days. A list of trading days is available on the BaFin’s homepage. While under the existing law, a notification requirement was only triggered once a relevant trade had actually settled, the Act now stipulates that shares are attributable to a shareholder if and when there is an unconditional claim for delivery of the shares without delay. As a consequence, the notification period for on- and off-market transactions that settle with immediate delivery pursuant to the respective market practice (in the EU typically T+2) begins on the trading day and not only as of the settlement date.

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The new rules apply to both sellers and buyers reaching or crossing a relevant threshold as a result of the transaction. In the case of conditional claims or settlement periods longer than market practice, the purchase rights must be disclosed as financial instruments that permit the holder to acquire shares.

Requirement to constantly monitor changes to an issuer's total number of voting rights

For so-called "passive threshold contacts" resulting from a change in the total number of voting rights of an issuer, the notification period will start at the time the disclosing party becomes aware of the change, but, at the latest, from the day the issuer publishes an updated number of total voting rights. As, going forward, updates need to be published by the issuer within two trading days after the change of the total voting rights has become effective (i.e. not at the end of a month as in the past), shareholders are required to permanently monitor the outstanding number of voting rights of an issuer to ensure timely compliance with the notification requirements.

Mandatory notification form

While in the past the BaFin has made available a voluntary voting rights notification form, the Act now prescribes the use of a newly designed notification form in the German language. We expect the BaFin to make available (and accept for notification purposes) an English language version of the form.

Amended definition of instruments triggering notification obligations

The Act extends voting rights notification obligations to holders of instruments "*creating an economic interest*" in an issuer's shares, in line with current UK rules. Previously, the notification obligation related to instruments resulting in an "*entitlement to acquire shares*". The exact scope of the notification obligations remains to be seen, especially since it makes reference to a non-exhaustive list of affected instruments to be prepared and maintained by the European Security and Markets Authority (ESMA).

Delta-adjusted reporting of cash-settled instruments

Also in line with current UK rules, the disclosure of cash-settled instruments will, in the future, have to be made on a delta-adjusted basis, as opposed to nominal positions. The delta of an equity derivative represents how the pay-off from that instrument changes in relation to a change in the price of the underlying equity, and ranges between zero and one. Cash-settled options have a fluctuating delta; this imposes ongoing monitoring obligations on the holders of such instruments, because changes in the delta can result in thresholds being crossed passively.

Drastic sanctions

The sanctions for violations of the disclosure obligations have been tightened severely and, in Germany, will go far beyond what is required by the amended EU Transparency Directive.

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In the future, administrative fines may amount to up to EUR 2 million for natural persons or up to the greater of EUR 10 million and 5% of the annual (consolidated) turnover of the preceding business year for undertakings. The BaFin may even impose administrative fines of twice the profit made or loss avoided. Against this background, notifying parties should monitor their direct and indirect holdings even closer.

While the pecuniary sanctions are painful, the loss of shareholder rights (in particular, voting or dividend rights) may be even more detrimental, especially in the context of public takeovers, activist situations or proxy contests. The loss of rights goes beyond the EU Transparency Directive not only in that it will occur automatically, but it is further triggered by any kind of negligence, rather than only by intentional breaches. The loss of rights will generally prevail and extend to any shares subsequently acquired until a correct disclosure is made. While previously the loss of rights applied only in case of a failure to disclose by the direct shareholder, its parent entities or persons holding the shares for the benefit of a third party, under the Act, it will apply irrespective of who failed to comply with the disclosure obligations. For instance, failures by one acting-in-concert party may, therefore, result in the loss of rights for all other concert parties. Likewise, the failure by an asset manager to notify the aggregate holdings of the funds it manages may result in a loss of rights for the individual fund(s) even if the notification obligations at the fund level were duly complied with.

Finally, the loss of rights will also be triggered by a violation of the disclosure obligation regarding derivatives or other instruments in respect of shares. However, in this case, the loss of rights will affect the shares held by the defaulting party only. For example, a violation to duly notify CFDs may result in a loss of rights once the underlying shares have been acquired, but will not affect the hedging position of the counterparty (e.g. the prime broker), as long as such counterparty complies with its own obligations.

Implementing the EU Transparency Directive's "naming and shaming" approach, any administrative actions taken by the BaFin for alleged violations of the disclosure obligations will be published on the BaFin's webpage, irrespective of whether such actions may still be appealed. This may create substantial reputational risks for an addressee even if it is subsequently decided that disclosure obligations were, in fact, not violated. Once the damage is done, experience shows that a rectification by the BaFin on its website may not fully rehabilitate an accused person. It remains to be seen whether the BaFin will exercise its discretion and delay publishing, or only publish anonymized information until appeals are finally decided upon.

Commencement of new rules/status notifications

The Act will come into force immediately following its promulgation, which is imminent. For holders of financial instruments relating to 5% or more of the voting rights of an issuer whose home member state is Germany, it will be necessary to make a status notification by January 15, 2016. The same obligation applies to holders of shares or financial instruments who have reached, exceeded or fallen below a notifying threshold solely due to the changes implemented by the Act.

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Timely advance preparation strongly recommended

In view of the complexity of the disclosure regime and the complicated corporate and contractual set-ups with which many institutional investors operate, preparatory measures should be considered timely in advance in order to be able to comply with the short notification period of four trading days. Those should include, amongst others:

- Review of corporate structure and determination of reporting requirements for all entities that may acquire shares in the future;
- Preparation of a reporting routine so that all necessary information (e.g. an up-to-date structure chart that in the future will need to be sent to the BaFin alongside notifications) is readily available;
- Preparation of necessary powers of attorney to prepare and file the respective notifications upon reaching or crossing a relevant notification threshold.

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