

Client Update

Germany Tightens Voting Rights Disclosure Regime and Steps Up Sanctions

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On 25 November 2015, Germany amended its voting rights disclosure regime, tightening the rules for notification of major holdings in listed companies and stepping up sanctions.¹

The German voting rights disclosure regime, in short, applies to holdings of, or instruments relating to, shares of German issuers that are admitted to trading on an organized market in the European Union (EU), such as the General or Prime Standard of the Frankfurt Stock Exchange.²

Large corporates, asset managers and other investors with holdings in German issuers should familiarize themselves immediately with this complex new regime which requires status notifications on a new mandatory standard notification form by 15 January 2016.

The Act provides for drastic new sanctions and the recent focus on violations of the voting rights notification obligations in the enforcement practice of the German Federal Financial Supervisory Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht – BaFin*) is expected to continue with increased acumen.

¹ These amendments in the German “Act Implementing the EU Transparency Directive Amending Directive (2013/50/EU)” (the “Act”) took immediate effect. Most of them are driven by the EU Transparency Directive Amending Directive (2013/50/EU) (the “Amending Directive”) which Member States had to implement by 27 November 2015.

² More precisely, it applies to issuers whose home country is Germany, i.e., issuers (1) who are domiciled in Germany and whose shares are admitted to trading on an organized market in Germany or in another member state of the EU or country of the European Economic Area (EEA) or (2) who are domiciled in a non-EEA country and whose shares are admitted to trading on an organized market in Germany and which have chosen Germany as their home country.

EARLIER NOTIFICATION REQUIRED

Investors whose shareholding reaches or crosses a threshold of 3, 5, 10, 15, 20, 25, 30, 50 or 75% of the voting rights have to notify the issuer and simultaneously BaFin within four trading days at the latest.³ The issuer must then publish such notification no later than three trading days following receipt of the notification.

Thus far, the notification period started on the settlement date when the transfer of ownership in the shares was completed. Now, the notification period generally starts already on the trading date, *i.e.*, the day on which the order is executed or the sale and purchase agreement is signed. Claims which are subject to conditions or settlement periods longer than T+2 must be disclosed as holdings in other instruments (see below).

EXTENDED ATTRIBUTION RULES FOR SHARES HELD BY A THIRD PARTY

Attributable to the transferee are now also voting rights which have been transferred separately from the underlying shares.⁴

Also attributable are voting rights attached to shares which are deposited as collateral with a third party provided that the collateral holder controls the voting rights and declares the intention to exercise them.

This rule supplements the existing rules that attribute voting rights in case of security transfers where legal ownership is transferred and the legal owner is the collateral holder. With respect to the latter, the German legislator incidentally abandoned the so-called “alternative attribution concept” according to which voting rights were attributed to either the transferor or the transferee. Now, the voting rights may be attributed to the transferor and the transferee. Hence, this new cumulative notification obligation may result in two separate notifications for the same shares.

³ A calendar of trading days can be found on BaFin’s website at www.bafin.de/SharedDocs/Downloads/EN/Liste/dl_kalender_handelstage_2015_en.pdf?__blob=publicationFile.

⁴ While such a separate transfer of voting rights is not permitted under German law, other jurisdictions permit such a transfer.

INTENSIFIED MONITORING OBLIGATIONS REGARDING NUMBER OF OUTSTANDING SHARES

Under the new rules, investors have to monitor the total number of outstanding shares of an issuer more closely and submit an updated notification if significant changes occur between the number of votes held by or attributed to them and the total number of votes that, in theory, can be cast in respect of the issued capital of an issuer. The latter can change significantly, *e.g.*, as the result of a share capital increase. Previously, the issuer published changes to the total number of voting rights only at month-end. Now, the issuer is generally obliged to publish the change within two trading days. The notification period for investors begins as soon as they learn of such a passive change, at the latest, however, with such publication by the issuer.

RECATEGORYIZATION OF INSTRUMENTS TRIGGERING NOTIFICATION OBLIGATIONS

The Act recategorizes instruments triggering notification obligations in accordance with the categories defined in the Amending Directive. The notification requirements for shareholders, except for the 3% threshold, now apply also to any person holding, directly or indirectly, instruments that

- on maturity, give the holder either (i) the unconditional right to acquire or (ii) the discretion as to his right to acquire, shares to which voting rights are attached, already issued; or
- are referenced to shares and with an economic effect similar to that of the above instruments, whether or not they confer a right to a physical settlement.

The reference to a “similar economic effect” is new. Previously, instruments had “to enable” their holder or a third party to acquire shares. The German legislator does not expect the new wording to broaden the scope of the existing notification obligations. Options, futures, swaps and contracts for difference will continue triggering notifications provided that they are, directly or indirectly, referenced to shares. The European Securities and Markets Authority (ESMA) will establish and periodically update an indicative list of instruments that are subject to notification requirements, taking into account technical developments on the financial markets.⁵

⁵ Cf. Art. 13 para. 1b of the Transparency Directive (2004/109/EC) as Amended by the Amending Directive.

NOTIFICATION OF CASH-SETTLED INSTRUMENTS ON A DELTA-ADJUSTED BASIS

The Act requires disclosure of cash-settled instruments on a “delta-adjusted” basis. The delta represents the number of shares that have to be held to perfectly hedge the exposure under the relevant instrument. For example, a cash-settled option that is “out of the money” will not be hedged to the same extent as one that is “in the money” and likely to be exercised.

Thus far, the rules provided for a fixed delta of 1. This means that disclosure of the full notional number of shares underlying the relevant instrument was required. Going forward, calculations have to be made on a delta-adjusted basis, by multiplying the notional amount of underlying shares by the delta of the instrument. This approach should reflect the holder’s real economic exposure to the underlying shares more accurately, but also requires an ongoing monitoring of the position since the delta-adjusted holding to be disclosed may vary over time even though no further transaction in the relevant instrument may have occurred.

MANDATORY NOTIFICATION FORM

In order to provide investors with comparable information on major holdings and to simplify the notification, the Act prescribes the use of a new mandatory standard notification form developed by ESMA.⁶

RELAXED GROUP REPORTING RULES

The Act relaxed the restrictions on group reporting, where notifications may be made by a parent company for its subsidiaries. Previously, group reporting was effectively only permitted if the person subject to the notification requirement belonged to a group for which consolidated financial statements had been prepared and whose parent company was a corporation with its registered seat in Germany. Now, group reporting is possible in any parent-subsidiary relationship, regardless of the legal form and location of the registered seat of the parent and its subsidiaries, respectively.

⁶ German and English language versions of the standard form are available on BaFin’s website at www.bafin.de/DE/Aufsicht/BoersenMaerkte/Transparenzpflichten/BedeutendeStimmrechtsanteile/bedeutendestimmrechtsanteile_node.html.

INCREASED FINES

The Act increases the fines for violation of the voting rights notification obligations drastically. Fines against natural persons may amount up to 2 million Euros and fines against legal persons may amount up to 10 million Euros or up to 5% of the (consolidated) turnover of the last fiscal year. BaFin may also impose fines up to twice the amount of the economic gain, which may be estimated on the basis of the profits made or losses avoided.

EXTENDED LOSS OF SHAREHOLDER RIGHTS

In case of violations of notification obligations, the Act provides for extended loss of shareholder rights, in particular, voting rights and dividend rights. Such loss of rights goes far beyond what is required by the Amending Directive. It might be even more painful than pecuniary sanctions, especially in public takeover or proxy contest situations.

The loss of shareholder rights does not require any BaFin action. It is the automatic consequence of any negligent or willful violation of a voting rights notification obligation, extends to shares acquired subsequently and generally prevails until a correct voting rights notification has been made (in certain circumstances, it may continue for another six months).

Thus far, this sanction applied only to a violation of the notification obligations for (i) direct shareholdings or (ii) attributed shareholdings which were held by a subsidiary or by a third party for the account of the person subject to the notification obligation.

Now, the loss of shareholder rights extends to all scenarios in which voting rights are attributed. For example, under the new rules, all parties acting in concert lose the rights attached to their shares if only one of them fails to correctly notify its (attributed) shareholdings. This is a particularly precarious change, as it may be difficult to assess whether investors are acting in concert and whether a notification therefore has to be made.

The loss of shareholder rights also extends to a violation of voting rights notification obligations in relation to instruments. Here, however, the loss of rights only affects the shares that are owned by the person who is subject to the notification obligation and does not extend to the shares underlying the instrument, e.g., to the shares held by the hedging counterparty to a cash-settled option.

The extended loss of rights will have a significant impact on issuers. Shareholders can be expected to challenge shareholder resolutions more frequently, asserting that certain shareholder votes were invalid because the respective shareholders had violated their notification obligations and thus lost their voting rights.

NAMING AND SHAMING

The Amending Directive demands publicity in relation to a violation of voting rights notification obligations. The Act therefore requires that any administrative actions and sanctions imposed by BaFin in relation to such violations must be published on BaFin's website, naming the violating natural or legal person and the rule violated. Under certain circumstances, BaFin may or is even required to delay such publication or to publish only an anonymized version.

The publication has to be made regardless of whether those actions and sanctions may still be appealed. In those cases, the publication has to show that the action or sanction may still be appealed and in case of a successful appeal, the publication has to be rectified.

STATUS NOTIFICATIONS

The Act requires status notifications by 15 January 2016 for any existing direct or indirect shareholding in a relevant issuer which becomes notifiable solely in view of the amendments to the attribution or aggregation rules for major shareholdings.

In addition, all existing holdings in instruments representing at least 5% of the voting rights have to be notified by such date. This obligation exists regardless of whether earlier notification obligations have been complied with.

All status notifications have to be made using the new mandatory standard notification form.

OUTLOOK

The new rules for the notification of voting rights require constant vigilance. While they increase transparency for the market, the complexity of these rules can easily expose investors and their directors, officers and employees to the drastic new sanctions.

In recent years, BaFin's enforcement practice has shown a clear focus on violations of voting rights notification obligations. This is likely to continue in view of a recent empirical study providing clear evidence of the significant influence of voting rights notifications on share price. The same study also showed that voting rights notifications, in many cases, were not filed within the notification period. The latter is likely to change in view of the stepped-up sanctions. However, the four-trading-day notification period paired with the requirement that not the investor, but the issuer, publishes the notification it receives within another three trading days, still can lead to significant disclosure delays and favors a secret building of or exiting from share holdings.

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Please do not hesitate to contact us with any questions.