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eurex circular 144/10

Date: Frankfurt, July 27, 2010
Recipients: All Trading Members of Eurex Deutschland and Eurex Zürich and Vendors
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German Equity and Bond Underlyings: World-Wide Ban on Naked Short Sales came into Force on July 27, 2010

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Content may be most important for:

- Front Office/Trading
- Middle + Backoffice
- Auditing/Security Coordination

Attachment:
Xetra Circular 088/10 from July 26, 2010

Summary:

German lawmaker outlaws naked short sales in

- equity underlyings and
- bond underlyings (denominated in Euro)

listed on a German exchange and in certain credit derivatives, effective as of **July 27, 2010**. Intraday naked short sales are permitted. Transparency provisions on net short positions will come into force after a 20-month interim period on March 26, 2012.

The world-wide ban does not affect Eurex products at all.

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German Equity and Bond Underlyings: World-Wide Ban on Naked Short Sales came into Force on July 27, 2010

Yesterday, the “Abusive Securities and Derivatives Trades Prevention Act” was announced in the German Federal Law Gazette, No. 38. The law came into force on July 27, 2010.

In accordance with the new statutory regulations for naked short sales in German equities, bonds and credit derivatives, traders in the cash market have to consider particularly the world-wide ban of naked short sales in German equities (whereby intraday naked short sales are permitted). According to BaFin, the German Federal Financial Supervisory Authority, exceptions are provided for Designated Sponsors, Liquidity Providers as well as for Lead Brokers and Specialists who are active in affected instruments. Comprehensive reporting requirements for short-selling positions will come into force on March 26, 2012, after an interim period of 20 months. In the meantime, the current BaFin decree as of March 4, 2010 remains effective.

The world-wide ban does not affect Eurex products at all.

Please find additional information about the law in an information memorandum and FAQ in the attachment. This supplementary service aims at bridging a potential information gap which could arise particularly with our international customers.

Frankfurt, July 27, 2010

Xetra Circular 088/10

Action required! High priority!

To all Xetra® Members and Vendors

Recipients: Nominated Persons, Traders, Central Coordinators, Security Administrators, System Administrators, General

July 26, 2010

World-Wide Ban on Naked Short Sales in German Equities to come into Force on July 27, 2010

Dear Sir or Madam,

Today, the "Abusive Securities and Derivatives Trades Prevention Act" has been announced in the German Federal Law Gazette, No. 38. The law will come into force on July 27, 2010.

Please consider the new statutory regulations for naked short sales in equities, bonds and credit derivatives, particularly the world-wide ban of naked short sales in German equities (whereby intraday naked short sales are permitted). According to BaFin, the German Federal Financial Supervisory Authority, exceptions are provided for Designated Sponsors, Liquidity Providers as well as for Lead Brokers and Specialists who are active in affected instruments – a respective notification must be given to BaFin immediately. Please refer to the BaFin website http://www.bafin.de for details and a reporting form for aforementioned exceptions.

Comprehensive reporting requirements for short-selling positions will come into force after a transition period of 20 months – in the meantime, the current BaFin decree as of March 4, 2010 remains effective.

Please find attached additional information about the law in an information memorandum and FAQ. This supplementary service aims at bridging a potential information gap which could arise particularly with our international customers.

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Yours faithfully,





Michael Krogmann
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Attachments
Xetra client information on German short sale regulation
Xetra FAQ on German short sale regulation

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Xetra Client Information

German Short Sale Regulation

Allows intraday naked short selling and facilitates transparency

New German law to regulate short sales

A new regulation has been put in place in Germany to regulate short sales. The *Abusive Securities- and Derivatives Trades Prevention Act*[1] will step into force on 27 July 2010. The Act provides changes to the *Securities Trading Act* (*Wertpapierhandels-gesetz*, WpHG).

The Act replaces the current General Decree of the Federal Financial Supervisory Authority (BaFIN) to prohibit naked short selling transactions of 18 May 2010. The General Decree on the introduction of a transparency obligation for net short-selling positions of BaFin of 4 March 2010 remains in place for the interim period of 20 months.

This note summarizes the main changes that are relevant for Xetra clients. It does not cover provisions on credit derivatives outlined in §30j WpHG. It does not cover provisions that empower BaFIN to conduct appropriate measures to protect the functioning of financial markets outlined in §4a WpHG.

Naked shorting of German shares banned globally

Naked short sales in shares or government[2] bonds (denominated in Euro) admitted to trading on a German exchange **are banned** (new §30h WpHG). The ban does not apply to shares of companies domiciled abroad.[3] The ban applies **globally, and irrespective of the trading venue.**

A 'naked short sale' applies when – at the **end of the day** when the trade was conducted – the seller

- is not the owner of the sold securities and
- does not have any unconditionally enforceable claim under the law of obligations or under property law for the transfer of title in a corresponding number of securities of the same kind.

Reporting of short positions required

(Covered) Net short positions in shares admitted to trading on a German exchange must be reported to the BaFIN until the end of the next trading day, if the net short position exceeds 0.2% of outstanding shares (new §30i WpHG).

If the net short position exceeds 0.5% of outstanding shares, the position must also be reported to the public via the Electronic Federal Gazette within said period.

Changes in the net position that exceed said thresholds in ±0.1% steps must be reported accordingly.

A 'net short position' applies when the net position of all financial instruments related to an issuer results in a short economic exposure to its owner.

Exemptions

Exemptions from the ban and the transparency obligations apply (§30h (2) sentence 1 and §30i (4) WpHG) to firms providing investment services, if they

- trade on own account on a regular and permanent basis, or
- fill client orders on a regular and permanent basis and hedge the resulting positions

and if the respective transaction is related to this business. BaFIN must immediately be given notice about the intent to take on these activities, whereas the affected instruments must be declared.

Exemptions from the ban apply (§30h (2) sentence 2) to transactions which trading participants conclude with the customer for settlement of a transaction in financial instruments at a fixed or definable price (fixed price transaction).

Fines

Not obeying these rules shall be deemed as an administrative offence and will be punished with a fine of

- up to 500.000 Euro for naked short selling,
- up to 200.000 Euro for not obeying transparency provisions.

Entry into force and Grandfathering clause

The ban is effective as of 27 July 2010. The ban does not apply to transactions conducted before the effective date, unless these are prohibited by a different rule.

The transparency requirement becomes effective on 26 March 2012. Net short positions that have been created before the effective date must be reported the day following the effective date, unless they have been reported earlier.

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Frankfurt am Main, 26 July 2010

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1 *Gesetz zur Vorbeugung gegen missbräuchliche Wertpapier- und Derivategeschäfte*

2 The term 'Government' includes national, regional, and local administrative units.

3 Except if the company is solely admitted to trading on a German exchange.

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Xetra Client Information

Short Selling FAQ

GENERAL QUESTIONS

Why is the regulation reintroduced?

The financial crisis has shaken confidence in the financial markets and increased the pressure for further substantial improvements to financial supervision. The expansion of the turbulence on the markets for government bonds of the EU Member States and the volatility of the euro reached a new dimension. It is therefore necessary to prohibit certain transactions that potentially aggravate the crisis and enhance transparency to these transactions.

How is the new regulation different to the existing one?

The *Abusive Securities- and Derivatives Trades Prevention Act* replaces the current General Decree of the Federal Financial Supervisory Authority (BaFIN) to prohibit naked short selling transactions of 18 May 2010.

The General Decree on the introduction of a transparency obligation for net short-selling positions of BaFIN of 4 March 2010 remains in place for the interim period of 20 months.

What are the changes regarding the ban?

Naked short sales in shares or government bonds (denominated in Euro) admitted to trading on a German exchange are banned. The ban does not apply to shares of companies domiciled abroad. The ban is effective as of 27 July 2010.

What are the changes regarding short position reporting?

Net short positions in shares must be reported to BaFIN and the public, once they exceed certain thresholds. The reporting requirement becomes effective on 26 March 2012.

What does the regulation cover, especially with respect to derivatives, swaps/CFDs, etc.?

The ban covers shares, government bonds, and certain credit derivatives (especially CDS) (new §30j WpHG).

To whom does the regulation apply – German companies only?

All naked short sales in shares or government bonds (denominated in Euro) admitted to trading on a German exchange are banned. The ban thus includes German shares, and bonds of the German government (new §30h WpHG), if they are listed on a German exchange. The ban also includes such credit derivatives where the contract has been constituted in Germany, unless the short position serves to hedge an existing risk.

Where does the regulation apply?

The regulation is valid world-wide.

Does the regulation apply to, e.g., trades on an MTF outside Germany?

Yes.

BAN-RELATED QUESTIONS

Will the naked short ban include intraday positions?

No. Only positions that are held at the end of the day are relevant. Within a trading day you are allowed to be uncovered short.

Is the ban applicable to naked intraday shorting (for purposes of Market Making) as well as naked overnight shorting?

Within a trading day everybody is allowed to be uncovered short. Naked short positions that are transferred to the next trading day are not allowed. Exemptions for liquidity provisioning activities exist (see below).

Do trading activities – where a buy and sell order are placed simultaneously, and the sell order is executed first – result in an illegal naked short sale?
This activity is allowed as long the naked short position is closed until the end of the day.

Do we have to show we have the borrow, and whether we have to tag the short sale orders?
No. The law does not contain provisions regarding evidence of borrowing. The law does not foresee tagging of individual short sale orders in a US style 'uptick rule'.

Is covered shorting allowed?
Yes. Everybody is allowed to create covered short positions and transfer these across trading days.

Are we allowed to short, if we enter into a pre-borrowing agreement with our clearer?
Yes,. Covered short sales are not subject to the ban.

How long is the ban expected to be in place?
The ban will be a permanent one. However, the German government has indicated to adapt the law accordingly once an EU-wide regulation is in place.

POSITION REPORTING-RELATED QUESTIONS

Is there any reporting necessary?
(Covered) Net short positions in shares admitted to trading on a German exchange must be reported to the BaFIN until the end of the next trading day, if the net short position exceeds 0.2% of outstanding shares.

In addition, if the net short position exceeds 0.5% of outstanding shares, the position must also be reported to the public via the Electronic Federal Gazette within said period.

Changes in the net position that exceed said thresholds in ±0.1% steps must be reported accordingly.

A 'net short position' applies when the net position of all financial instruments related to an issuer results in a short economic exposure to its owner. (new §30i WpHG)

When do I have to start with short position reporting?
The reporting requirement starts after an interim period of 20 months on 26 March 2012.

EXEMPTIONS-RELATED QUESTIONS

Are liquidity providers, such as market makers, designated sponsors etc. exempt from the ban?
Yes. Exemptions from the ban apply (§30h (2) sentence 1) to firms providing investment services, if they

- trade on own account on a regular and permanent basis, or
- fill client orders on a regular and permanent basis and hedge the resulting positions

and if the respective transaction is related to this business. BaFIN must immediately be given notice about the intent to take on these activities, whereas the affected instruments must be declared.

These exemptions include, inter alia, market makers, Designated Sponsors, Liquidity Providers, Skontroführers, Specialists, and other comparable market participants – if the respective short sale is related to this business.

Exemptions from the ban apply (§30h (2) sentence 2) also to transactions carried out on the basis of a fixed price with a client.

Are liquidity providers, such as market makers,

designated sponsors etc. exempt from the reporting requirement?

Exemptions from the transparency requirement apply (§30i (4) WpHG) to firms providing investment services, if they

- trade on own account on a regular and permanent basis, or
- fill client orders on a regular and permanent basis and hedge the resulting positions

and if the respective transaction is related to this business. BaFIN must immediately be given notice about the intent to take on these activities, whereas the affected instruments must be declared.

How do we apply for an exemption of the short selling rules?

An explicit application is not necessary. However, BaFIN must immediately be given notice about the intent to take on these activities, whereas the affected instruments must be declared (WpHG 30h (2) sentence 3; 30i (4) sentence 2; and 30j (3) sentence 2).

RESPONSIBILITY, FINE-RELATED QUESTIONS, AND ENFORCEMENT

What are consequences if we fail to cover short positions until the end of the day?

Not obeying these rules shall be deemed as an administrative offence and will be punished with a fine of up to 500.000 Euro for naked short selling.

Who is ultimately responsible in supervising compliance with the new law?

Any seller of securities is responsible for his own business.

How is the law going to be enforced globally?

BaFIN will enforce the regulation in Germany. In other jurisdictions, BaFIN will seek the administrative assistance of the respective national Competent Authorities.

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