

German Government Proposal Narrows Derivatives Ban

June 4, 2010

On May 18, the German Federal Financial Supervisory Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht*, or BaFin) issued three decrees that are aimed at banning naked short selling and certain credit default swap (CDS) transactions. On May 25, as an extension of such bans, the German government pushed forward a separate discussion draft of an act designed to strengthen the stability of the capital markets (Stability Act), which bans certain transactions regarded as a threat to the capital markets' stability.¹ The discussion draft of the Stability Act provided for a ban on uncovered short selling of all shares traded on a regulated market of a German stock exchange, on uncovered CDS transactions and, including short and long positions, on transactions in currency derivatives that do not constitute a hedge for an existing position.

Carve Out of Currency and Equity Derivatives from Statutory Ban

On June 2, a new draft legislation was published by the German government that, compared to the discussion proposal issued May 25, would narrow the *statutory* bans. The draft legislation still provides for a ban on uncovered short selling of all German shares traded on a regulated market of a German stock exchange as well as one on naked short selling of government bonds of the eurozone and uncovered CDS trading.

However, the new proposal no longer contains a statutory ban (i) on transactions in currency derivatives that derive their value directly or indirectly from the exchange rate of the Euro or (ii) on transactions in derivatives that synthetically replicate an uncovered short sale of German shares or of government bonds of the eurozone. Instead of a statutory ban, the German Finance Ministry and the BaFin are given discretion to impose such restrictions through later regulation if necessary for the stability of the financial markets. This more practical approach has been welcomed by market participants.

We will keep you updated on further developments. If you have any questions or would like more information on any of the issues discussed in this LawFlash, please contact either of the following

¹ To read more about these decrees and the original proposal of the Stability Act, see the Morgan Lewis LawFlashes, "German Federal Government Proposes to Extend the Ban on Short Selling in Germany" (dated May 27, 2010), available online at http://www.morganlewis.com/pubs/IMLF_BaFinBansShortSelling_19may10.pdf, and "BaFin Bans Naked Short Selling and Certain Credit Default Swaps" (dated May 19, 2010), available online at http://www.morganlewis.com/pubs/IM_ShortSellingInGermany_LF_27may10.pdf.

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