

Short Selling Regulation Review

Call for Evidence

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Ministerial Foreword

The UK's financial services sector is one of the most open, innovative, and dynamic in the world. I am proud that so many investors and businesses turn to the UK markets to finance their business opportunities and investments. Since our exit from the EU, the government's focus has been ensuring financial services regulation supports the resilience and competitiveness of the financial services sector and helps the UK economy grow.

Short selling plays a healthy role in the proper functioning of financial markets. It provides essential liquidity to markets which drives investment in British firms, emboldens economic growth, and helps ensure investors pay the right price when investing in shares. Short selling is also essential to enable investors to manage risks in their portfolios by hedging against their investments. This ensures investors can provide capital to firms which may otherwise struggle to find investments, which encourages economic growth.

When the UK left the EU the short selling regulation was one of many EU regulations brought onto the UK statute book. The government has taken powers in the Financial Services and Markets Bill to repeal EU law in a measured way and ensure regulation is shaped around the interests of the UK economy. This call for evidence is part of the government's work to take advantage of the UK's new freedoms outside of the EU, building upon our historic strengths to renew the UK's position as one of the world's pre-eminent financial centres, and support growth in the wider economy.

The short selling regulation was introduced in the EU in 2012 and was developed, out of necessity, to reflect and take account of differing views across member states. Now we have left the EU we can design a short selling regulation that is tailored to the needs of UK markets, companies and investors. The government recognises the need for regulation of short selling in a way that supports market integrity and public confidence. However, it is important that we remove any unnecessary burdens which result from the EU regulation.

This call for evidence is the start of this government's work to design a short selling regime for the UK which helps deliver strong and sustainable growth.

Chapter 1

Introduction

Short Selling

1.1 Short selling is the practice of borrowing a security and selling it at the current market value with the expectation that the price is going to fall. The intention is for the short seller to repurchase the security for a lower price, at a later date, and to make a profit from the difference after returning the securities to the lender.

1.2 Short selling can be used as an investment strategy by investors when they believe that a security is overpriced and will, therefore, fall in price. It can also be used by investors as a hedging strategy, to manage and reduce the risk of the long positions that they hold, including their investments in companies.

1.3 Short selling therefore plays an important and beneficial role in the orderly and effective functioning of financial markets, by supporting liquidity and risk management and increasing market confidence. By providing additional liquidity, and the opportunity to hedge against long positions, short selling supports the functioning of markets and enables firms to raise funds. Specifically, short selling contributes to the efficiency of prices by helping both positive and negative information about companies to be accurately and promptly reflected in the prices of securities. This protects investors by ensuring that securities are not over-valued. Short selling activities also ensure that research on companies is incorporated into prices by providing information on the robustness of a company's business models and identifying corporate governance issues and potentially fraudulent practices or activities. There have been various examples where short sellers have identified governance issues within firms before regulators and other market participants.

1.4 However, there can also be risks specifically associated with short selling. Principally, the losses that short sellers can incur if the price of a shorted security increases rather than falls have no upper bound – making the practice inherently more risky than traditional investment. Moreover, in exceptional periods, markets may not function in an orderly manner, and in such circumstances there is a risk that short selling can exacerbate volatility and uncertainty in the market by creating a negative feedback loop, and in doing so can undermine market integrity and price discovery. In some cases, short selling has also been perceived (whether rightly or wrongly) negatively, as short sellers are seen to profit from falling share prices. Some have raised concerns about market abuse risks in this context, if market

participants somehow seek to drive down prices deliberately alongside taking short positions.

1.5 The first principle of a regulatory regime for short selling therefore is facilitating short selling and the benefits it provides to the orderly and effective functioning of the market, whilst protecting against risks. This call for evidence seeks information to ensure that this balance is correctly met in the UK regulatory framework.

Regulation of Short Selling

1.6 Short selling is regulated in the UK by the Short Selling Regulation (SSR). This is the UK version of the EU Short Selling Regulation ('EU SSR'),¹ as incorporated into UK law by the European Union (Withdrawal Act) 2018.²

1.7 The SSR applies to the short selling of securities that are 'publicly traded' (i.e., admitted to trading on a UK Regulated Market or UK MTF), to UK sovereign debt and to the use of credit default swaps in relation to UK sovereign debt. The SSR also accounts for a short position being taken through the use of derivatives.

1.8 The EU SSR was introduced in 2012, in response to concerns over the short selling of shares in financial institutions and the short selling of euro area sovereign debt, including through credit default swaps, during the 2008 financial crisis.³ In particular, there were concerns about the lack of information and transparency to the market and authorities on whether and how short selling was impacting prices, exacerbating uncertainty and downward price movements, and increasing the risk to financial stability.

1.9 Prior to the EU SSR, the UK had a standalone short selling regime. The Financial Services Authority (FSA) introduced a temporary short selling ban and a public disclosure regime for UK financial sector companies in 2008. The FSA introduced a permanent public disclosure regime in 2010 for securities of a publicly traded company admitted subject to a rights issue and UK financial sector companies. The reporting threshold under this regime was 0.25% of the issued share capital of a company.

1.10 All other major financial services jurisdictions have some form of regulatory regime for short selling to protect against the risks outlined in this call for evidence. In line with IOSCO standards⁴, many of those regimes share features with the SSR, such as the restrictions on uncovered short selling, disclosure requirements and arrangements to

¹ Regulation (EU) No 236/2012

² Amended by Short Selling (Amendment) (EU Exit), <http://www.legislation.gov.uk/ukxi/2018/1321/contents/made>

³ Regulation (EU) No 236/2012 of the European Parliament and of the Council, <[EUR-Lex - 32012R0236 - EN - EUR-Lex \(europa.eu\)](#)>

⁴ IOSCO, 'REGULATION OF SHORT SELLING', 2009, <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD292.pdf>

manage the risk of short selling activities (e.g., the power to introduce bans).

Future Regulatory Framework Review

1.11 The Future Regulatory Framework (FRF) Review was established to determine how the financial services regulatory framework should adapt to the UK's new position outside of the European Union (EU), and how to ensure the framework is fit for the future.

1.12 The UK's domestic model for regulation is principally set in the Financial Services and Markets Act (FSMA) 2000. Under this model of regulation, the financial services regulators are generally responsible for making the detailed regulatory requirements that apply to firms, operating within a framework established by government and Parliament. The FRF Review concluded that the UK should establish a comprehensive FSMA model of financial services regulation.

1.13 The Financial Services and Markets (FSM) Bill, which is currently before Parliament, seizes the opportunities of EU Exit, tailoring financial services regulation to UK markets to bolster the competitiveness of the UK as a global financial centre and deliver better outcomes for consumers and businesses. In particular, it implements the outcomes of the FRF Review – it makes enhancements to the FSMA model, and repeals retained EU law so that it can be replaced with regulation designed for the UK. The government has set out its intended approach to implementing these subsequent reforms⁵.

1.14 The government intends to repeal the Short Selling Regulation. This call for evidence represents the first step towards replacing retained EU law in this area with a regulatory framework specifically tailored to the UK. The government is seeking evidence to help it understand the views of market participants towards the practice of short selling and whether and how the practice should best be regulated. The responses to this call for evidence will inform considerations as to the appropriate framework for the regulation of short selling.

Scope of the Call for Evidence

1.15 As outlined above, this review of the SSR intends to ensure that the UK's approach to regulating the short selling of shares admitted to trading reflects the specificities of UK markets, continuing to facilitate the benefits of short selling, whilst also protecting market participants and supporting market integrity.

1.16 This call for evidence does not explore other provisions in the SSR including the short selling regime for UK sovereign debt and UK

⁵ 'Building a smarter financial services framework for the UK', 09 December 2022, <https://www.gov.uk/government/publications/building-a-smarter-financial-services-framework-for-the-uk>

sovereign credit default swaps, which the government will consider later as part of the process to repeal retained EU law in this area and replace it with a regulatory framework tailored to the UK.

1.17 The government is also seeking to understand further where firms find that the requirements under the SSR interact with requirements under other regulations, such as the Market Abuse Regulation (MAR), the Central Securities Depositories Regulation (CSDR), Securities Financing Transactions Regulation (SFTR) and the Markets in Financial Instruments framework (MiFID). Where relevant please keep this in mind in your responses to the questions in this call for evidence.

1.18 The government welcomes views on the UK's short selling regime from all interested stakeholders including but not limited to investors, issuers, securities lenders, trading venues, and other market participants.

Box 1.A Questions

- 1. Do you agree that the activity of short selling plays an important role in the efficient functioning of financial markets?*
- 2. Do you think that the activity of short selling should be regulated in the UK? Please briefly explain why or why not.*
- 3. Do you think the SSR puts a proportionate regulatory burden on short sellers in the UK market? Please briefly set out why.*
- 4. Are there aspects of the SSR which you consider to be essential for ensuring market stability and confidence in the activity of short selling?*
- 5. In your view would it be preferable to modify the existing SSR to reflect the UK markets, but keep the core framework unchanged, or do you think there is a case for fundamental reform?*
- 6. Are there aspects of other jurisdictions' short selling regulations that you think operate better than the SSR?*

Chapter 2

The Short Selling Regulation

2.1 In addition to the questions above, the government is seeking to gather views on the operation of the current UK short selling regime. These views will be used to inform the design of the regime that will replace the SSR. As part of this process, the government will consider which aspects of the regime should remain in legislation, and which should be delegated to the Financial Conduct Authority (FCA) to set in its rules.

Restrictions on ‘uncovered’ short selling

2.2 The SSR requires persons to cover their short selling transactions, and sets out detailed requirements as to the covering arrangements, which include either: a) borrowing securities from a lender, b) agreeing to borrow securities from a lender, and c) ‘locate arrangements’ where a lender confirms that it has located securities and can deliver securities.

2.3 The SSR therefore restricts ‘uncovered’ (also known as ‘naked’) short selling, by preventing persons from entering into a short selling transaction without having covering arrangements in place to be able to settle the position. Restrictions on uncovered short selling are a core part of the regulation of short selling, the purpose of which is to prevent settlement failures disrupting the orderly functioning of the market and prevent shorting of more shares than already exist in the market. As noted in paragraph 10, restrictions on uncovered short selling is a common feature of market regulation globally.

2.4 The government is seeking views on whether the current arrangements for covering securities in the SSR and the current arrangements for settlement discipline adequately protect against settlement risks and disorderly markets⁶.

2.5 For example, the government would like to understand the effectiveness of borrowing and locate arrangements between short sellers and securities, such as the robustness of the commitment of securities lenders to deliver securities on time to effect settlement and

⁶ The settlement rules sit in the non-legal and non-regulatory CREST Settlement Discipline Regime operated by Euroclear UK & International

the transparency of the arrangements for the owners of securities consenting for their securities to be used for short selling activities.

Box 2.A Questions

7. *Do you consider that uncovered short selling restrictions under the SSR are appropriate?*
8. *Do you consider that current uncovered short selling restrictions are working effectively to reduce risks to settlement and the orderly functioning of the market, in particular current locate arrangements? What arrangements do you use and why are they effective?*
9. *Is short selling activity causing settlement failures? Do current UK settlement discipline arrangements need to be changed to reduce the risk of short selling causing settlement failures? What changes could be made and why?*

Disclosure Requirements

Position Reporting to the FCA

2.6 The SSR requires that persons notify the FCA where they have a net short position that exceeds 0.1% of issued share capital of a publicly traded company.⁷ Persons must report incremental 0.1% changes above that threshold. Most other jurisdictions require either public or regulator reporting, or both and a variety of thresholds. As noted in paragraph 10, some level of position reporting to regulators is a common feature of short selling regulation in all leading jurisdictions.

2.7 The FCA uses position reports to identify companies subject to net short positions and persons who have net short positions in those companies. This information, alongside other information it receives, such as transaction reporting under MiFID and suspicious transaction and order reports under MAR, enables the FCA to track net short positions in the market and to proactively engage with firms to address how their net short positions and related trading activities are impacting on the market. The engagement also helps the FCA identify possible misconduct by companies. The lowering of the reporting threshold from 0.2% to 0.1% has significantly increased the FCA's visibility over the number of companies subject to net short positions and the size of those net short positions, enabling the FCA to engage

⁷ A net short position refers to the number of shares which a person has shorted, minus the number of long positions that person holds in the same security

with firms earlier. The FCA engaged with 50 firms in the year between October 2021 and October 2022 to discuss their net short positions.

2.8 The government appreciates that firms will incur costs in identifying where net short positions have met the threshold and in submitting notifications to the FCA. FCA data shows that firms send around 3,250 position reports a month to the FCA. 50% of position reporting below the 0.5% public disclosure threshold comes from 10 firms. The government, therefore, seeks to understand whether reporting costs are proportionate and to gather views on whether there are changes that could be made to reduce those costs, whilst maintaining the benefits of FCA monitoring and supervision as set out above. This could include changes to the reporting thresholds (including reverting to 0.2%), changes to improve the availability of information needed to calculate short positions, or operational changes to automate FCA arrangements for receiving reporting.

Box 2.B Questions

- 10. Should the FCA specifically monitor short selling?*
- 11. Does the FCA monitoring of short selling help support market integrity and market confidence?*
- 12. What are the costs and burdens for your firm for sending position reports to the FCA? Please provide any evidence. Are there specific position reporting requirements or arrangements that could be changed to alleviate the cost and burdens of reporting?*
- 13. Do you think the current reporting threshold and increments are set at the appropriate level? Do you think there are any benefits or risks associated with amending the current threshold? In particular, would you support reverting the threshold to 0.2%? Is 0.2% still too small?*
- 14. Are there other adjustments to the reporting requirements which you would suggest?*

Public Disclosure

2.9 The SSR also requires persons to publicly disclose to the market where they have a net short position that exceeds 0.5% of issued share capital of a publicly traded company. Persons also have to publicly disclose incremental 0.1% changes above that threshold. The FCA publishes these positions on its website, based on the position reporting it receives from firms. The information published includes the name of the position holder, the name of the company which the net short position is held in, and the size of the net short position expressed

as a percentage of issued share capital.⁸ As noted in the previous section, it is common for short selling regimes in other jurisdictions to include a public disclosure requirement, however there is more variety in whether it is limited to disclosing the identity of the company whose instruments are being shorted or – as in the UK and EU – also identifying the firm which is undertaking the short selling activity. There is also a wide variety in thresholds used for public reporting. As noted in paragraph 10, some form of public reporting of short positions is a common feature of other jurisdictions' short selling regulation.

2.10 The objective of the public disclosure requirement is to provide investors with information and transparency on how short selling affects the price of securities, and in doing so provide certainty and confidence to the market. The UK's public disclosure regime may in some cases also act as a disincentive to investors from taking out large net short positions, as they need to consider whether they wish to be identified to the public before choosing to continue with their strategy.

2.11 However, the government seeks to understand whether the current SSR public disclosure requirements are working as originally intended and whether they are unnecessarily discouraging short selling activities to the detriment of the effective functioning of the market. Some argue that public disclosures make them vulnerable to short squeezes from other investors and it may lead to 'copy-cat' behaviour where other investors copy positions or can benefit from their research. If the public threshold unnecessarily discourages market participants from holding larger net short positions, this could adversely impact market liquidity and the price discovery process by delaying or limiting the extent to which an alternative view is incorporated into prices.

2.12 The government seeks views on the purpose and value of public disclosure of short positions, and the effectiveness of the current regime, in particular the appropriateness of naming the position holder.

Box 2.C Questions

15. *Do you support the requirement to publicly disclose net short positions under the SSR? What would be the impact to your firm or the market if public disclosure requirements were to be removed?*
16. *How do you use public net short position disclosures and how does it support your firm's activity or the market?*
17. *Do the public disclosure requirements contribute to or create any unnecessary barriers to short selling? If yes, please provide details.*

⁸ The content of information needing to be published by FCA is set by technical standards, <https://www.handbook.fca.org.uk/techstandards/SSR/2012/reg_del_2012_826_oj/annex01.html>

18. Are there public disclosure requirements that could be changed to remove any unnecessary barriers to short selling? For example, do the identities of the position holders need to be disclosed and what would be the impact on your firm and the market from removing this?

19. Do you consider that public disclosure requirements could be improved to increase transparency to the market? What are your views on publishing a net aggregated positions report to supplement or replace current reporting arrangements?

Market Maker Exemption

2.13 Market makers play an important role in supporting market functioning, offering to both buy and sell a tradable asset, and in doing so providing liquidity to the market. Under the SSR, market makers are exempt from certain requirements.⁹ This includes the requirements to report and disclose net short positions to the FCA and to the market, and the restrictions on uncovered short selling. The purpose of the market maker exemption is to prevent market makers being subject to requirements that would discourage them from undertaking their activities.

2.14 To receive an exemption, market makers are required to submit a notification to the FCA in writing at least 30 calendar days before they intend to use it to demonstrate that they are market maker and market making in the relevant financial instruments.

2.15 The SSR provides that HM government may determine that an overseas jurisdiction's legal and regulatory framework are equivalent to the UK's own framework for the purposes of the market maker exemption. This means that overseas market makers can qualify for an exemption where they are a member of a trading venue in that overseas jurisdiction.

2.16 The government is seeking views on the current functioning of the market maker exemption, and whether there are opportunities to streamline the market maker exemption process and arrangements to make it more efficient for market makers to receive an exemption and perform their market making activities. Any changes would need to be balanced against the risk that ineligible market participants might receive exemptions.

⁹ Chapter IV, article XVII

Box 2.D Questions

20. Do you think the current market maker exemption regime in the SSR functions efficiently? Are there aspects of the market maker exemption regime requirements or arrangements that could be changed to reduce burdens and improve its efficiency?

Emergency Intervention Powers

2.17 The SSR provides the FCA with powers to restrict short selling in certain circumstances to protect the orderly functioning of the market or in response to a serious threat to financial stability or market confidence.¹⁰

2.18 Firstly, the FCA can apply a short-term ban on the short selling of a financial instrument for the next day of trading where the price of an instrument falls significantly during the trading day. The FCA can only impose a ban to prevent the disorderly decline in the price of a financial instrument.

2.19 Secondly, the FCA can impose a long-term ban of up to three months on the short selling of a financial instrument in exceptional circumstances. These circumstances relate to adverse events or developments which pose a serious threat to financial stability or market confidence. It can only be imposed where the measure is necessary to address the threat, and when it will not have a detrimental impact on the market which is disproportionate to its benefits.

2.20 For both bans the FCA can apply certain exemptions, such as excluding activities (such as market making) or financial instruments (such as ETFs, indices, or baskets).

2.21 The short selling ban is intended to address some of the potential risks associated with short selling in exceptional market conditions outlined in the introduction. A short selling ban is intended to help to reduce downward price movements and volatility but to still facilitate other market making and risk management activities, stabilising the market by counteracting any negative feedback loop which is causing a downward spiral in prices and irrational behaviour by investors.

2.22 However, the government is aware of differing views as to the effectiveness of bans. For example, evidence from the use of previous bans globally suggests that they may not reduce a fall in price or volatility, but can reduce liquidity and prevent participants from undertaking hedging activities.

¹⁰ Chapter V, section I, articles XVIII-XXV

2.23 The FCA has made clear that it would only apply a short selling ban in very exceptional market conditions as a last resort and that they would 'set a high bar on imposing any bans.'¹¹

2.24 The powers under the SSR are not the only powers the FCA has to intervene in markets. The FCA has separate powers to suspend the trading of a financial instrument although these are designed for other activities and circumstances such as listing rules, market abuse, and trading venues. However, these powers would prevent any selling or buying in relation to the financial instrument. The FCA's powers under the SSR enable the FCA to specifically only target short selling activity, and to not prevent other buying and selling activity in relation to that financial instrument.

2.25 The government is seeking views on the purpose and effectiveness of the FCA having the power to apply short selling bans, whether changes could be made to improve the application and functioning of short selling bans, whether and what alternative arrangements could be put in place, and whether the FCA should retain powers to be able to apply short selling bans.

Box 2.E Questions

- 21. Do you consider the FCA should have powers to intervene in the market in relation to short selling activity in exceptional circumstances? What would be the impact if short selling bans were to be removed under the UK regime?*
- 22. Do you think any changes could be made to increase the effectiveness of existing short selling bans?*
- 23. Are there any alternative arrangements to short selling bans that could be put in place (including arrangements from other jurisdictions)?*

Overseas Shares

2.26 The FCA is required to maintain a list of overseas shares (referred to as 'third country shares' in the SSR) which are exempt from the SSR and to update that list every two years. The FCA determines whether a share is exempt by calculating whether a clear majority of trading in a share is undertaken in all the trading venues overseas. The list is a 'negative' list which sets out what overseas shares do not need to be reported rather than a 'positive' list which sets out what shares do need to be reported.

¹¹ FCA Statement in Short Selling Bans and Reporting, 17 March 2022, <https://www.fca.org.uk/markets/short-selling/statement-short-selling-bans-and-reporting>

2.27 The government is seeking views on the current arrangements for overseas shares and how these arrangements could be made more effective and reduce burdens for firms.

Box 2.F Questions

24. Do you consider that the current requirements and arrangements for overseas shares are effective? What changes could be made to improve the arrangements for overseas shares under the SSR? Could the overseas shares list be changed to a "positive" list of shares that are required to be reported/covered by market participants?

Other Considerations

2.28 This call for evidence has set out the areas which the government wishes to explore in greater detail in this review of the SSR. However, the government would welcome views on any other aspects of the SSR that have not been explicitly addressed in the areas and questions above, including the requirements relating to UK sovereign debt and the use of credit default swaps in relation to UK sovereign debt.

2.29 The government would also welcome views on whether changes to the UK short selling regime would increase burdens on firms who operate in multiple jurisdictions and may be required to implement and maintain different systems and controls.

Box 2.G Questions

25. Please provide any further views on the SSR, including views on the arrangements relating to sovereign debt and sovereign credit default swaps.

26. For firms operating in multiple jurisdictions, please provide views on the potential operational impact of changes to the UK short selling regime (e.g. IT changes).

Chapter 3

When and how to submit your responses

This call for evidence will remain open for three months, and close on 5 March 2023.

Please submit your responses to MarketConduct@hmtreasury.gov.uk

Or post your response to:
Short Selling Call for Evidence
Securities and Markets
1 Red HM Treasury
1 Horse Guards Road
SW1A 2HQ

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This document can be downloaded from www.gov.uk

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