UK FINANCE

HM TREASURY: SHORT SELLING REGULATION REVIEW

Call for Evidence

March 2023

UK FINANCE

Linklaters

HM Treasury: Short Selling Regulation Review

Call for Evidence

UK Finance response

About UK Finance

UK Finance is the collective voice for the banking and finance industry. Representing more than 300 firms across the industry, it seeks to enhance competitiveness, support customers and facilitate innovation. Our primary role is to help our members ensure that the UK retains its position as a global leader in financial services. To do this, we facilitate industry-wide collaboration, provide data and evidence-backed representation with policy makers and regulators, and promote the actions necessary to protect the financial system. UK Finance's operational activity enhances members' own services in situations where collective industry action adds value. Our members include both large and small firms, national and regional, domestic and international, corporate and mutual, retail and wholesale, physical and virtual, banks and non-banks. Further information is available at **www.ukfinance.org.uk**.

Key contacts

Kevin Gaffney, Director Secondary Markets and Post Trade Policy,
Capital Markets and Wholesale Policy, **Kevin.Gaffney@ukfinance.org.uk**

Ayesha Ghafoor, Principal, Capital Markets and Wholesale Policy, **Ayesha.Ghafoor@ukfinance.org.uk**

Yvonne Harte, Principal, Capital Markets and Wholesale Policy, **Yvonne.Harte@ukfinance.org.uk**

Alberto Sicari, Analyst, Capital Markets and Wholesale Policy, **Alberto.Sicari@ukfinance.org.uk**

About Linklaters

Linklaters LLP is a leading international law firm, specialising in innovative, complex work for investment banks, asset managers, exchanges, private and public companies and their owners, private equity houses and governments. We offer a full cycle service for our clients, including advice on complex regulatory issues, IPOs, mergers & acquisitions, corporate finance and dispute resolution. We have a market leading financial services practice that is ranked band 1 by the key legal directories (Chambers and Legal 500) and considered to be at the forefront of market and regulatory developments. We aim to build enduring relationships with our clients and to be their lawyers of choice for their most important mandates. Further information is available at **www.linklaters.com**.

Key contacts

Raza Naeem, Partner, Financial Regulation Group **Raza.Naeem@linklaters.com**

James Morris, Managing Associate, Financial Regulation Group **James.Morris@linklaters.com**

Simon Treacy, Senior Associate (Knowledge), Financial Regulation Group **Simon.Treacy@linklaters.com**

HM Treasury Short Selling Regulation Review Call for Evidence

UK Finance Response

Date: 3 March 2023

Sent to: **MarketConduct@hmtreasury.gov.uk**
tom.duggan@hmtreasury.gov.uk
eddie.kaye@hmtreasury.gov.uk

Dear Tom and Eddie,

Please find enclosed the UK Finance response to the Short Selling Review Call for Evidence, produced with the advisory support of Linklaters LLP.

We welcome this opportunity to share our views and recommendations for improving the UK's short selling regime, in line with HM Government's objectives around tailoring our regulatory regime to UK markets, supporting market integrity and bolstering the competitiveness of UK capital markets.

Overall, we believe the current short selling regime works well and wish to emphasise that the market maker exemption is critical for the effective functioning of the market.

There are, however, targeted technical refinements concerning the application process for the market maker exemption that could improve the regime further. We believe these reforms should collectively contribute to a more competitive, agile and open regime for firms operating in the UK.

If you have any questions in relation to the information within our submission, please do not hesitate to get in touch.

Kind regards,

Kevin Gaffney

Questions and answers

1. **Do you agree that the activity of short selling plays an important role in the efficient functioning of financial markets?**

   Yes, UK Finance members agree that short selling plays an important role in the efficient functioning of financial markets by supporting liquidity and risk management, which increases market confidence.

2. **Do you think that the activity of short selling should be regulated in the UK? Please briefly explain why or why not.**

   Yes, UK Finance members agree that, consistent with international standards, the activity of short selling should be regulated in the UK in order to uphold market integrity and public confidence, provided that short selling continues to be regulated in a proportionate manner and with appropriate exemptions for market makers.

3. **Do you think the SSR puts a proportionate regulatory burden on short sellers in the UK market? Please briefly set out why.**

   UK Finance members agree that the SSR is proportionate overall but there are measures which could be taken to ensure that the administrative burden of compliance is more proportionate relative to the benefits of the regime. (See for example our comments below on the market making exemption, the disclosure regime for net short positions and the application of emergency intervention powers).

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?**

   Restrictions on uncovered short selling are necessary to support market confidence. The exemption for market making is also essential to ensure market stability and the continued provision of liquidity by firms operating under the exemption.

5. **In your view would it be preferable to modify the existing SSR to reflect UK markets, but keep the core framework unchanged, or do you think there is a case for fundamental reform?**

   UK Finance members believe that the regime is working well and does not need fundamental reform. However, we note that there are aspects of the regime that could be refined so that it operates in a more proportionate manner. (See for example our responses below on the market making exemption, the disclosure regime and the application of emergency powers).

   Members would caution against any changes to the regime that would require arrangements with clients or counterparties to be repapered, which would incur significant administrative costs, disruption and provide little benefit.

6. **Are there any aspects of other jurisdictions' short selling regulations that you think operate better than the SSR?**

   Relative to some other jurisdictions, the UK can be lauded for the pragmatic approach it has taken in its regulation of its short selling regime and, in particular, the cautious approach it has taken to the exercise of bans on short selling.

   There are aspects of other regimes which the UK could draw from. In particular, UK Finance members would support the creation of a positive securities list (see below). This would be similar to the approach taken in Hong Kong where the regulator provides a list of securities subject to the notification requirements.

7. **Do you consider that uncovered short selling restrictions under the SSR are appropriate?**

   The uncovered short selling restrictions under the SSR are appropriate provided that the exemption for market makers remains in place. The regime relating to uncovered short selling would become unjustifiably restrictive if the market making exemption were removed.

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?**

   UK Finance members believe that the current restrictions work well in the UK. The regime provides for a variety of methods that have been adapted for UK markets and that provide effective options for a variety of market participants.

   UK Finance members would caution against changes to the rules on locate arrangements which would require a client/counterparty repapering exercise, as would be the case for certain changes to the EU's Short Selling Regulation that have been proposed by the European Securities and Markets Association (ESMA), because this would impose unnecessary costs on providers of locates for no additional benefit.

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?**

   UK Finance members do not believe that short selling is a major cause of settlement failures. In the experience of UK Finance members settlement failures are more closely aligned with operational and custody issues, and general friction in the market, rather than short selling activity.

Disclosure Requirements
Position Reporting to the FCA

10. **Should the FCA specifically monitor short selling?**

    Yes, UK Finance members agree that the FCA should monitor short selling.

11. **Does the FCA monitoring of short selling help support market integrity and market confidence?**

    Yes, UK Finance members agree that FCA monitoring of short selling helps 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?**

    When the SSR disclosure requirements were introduced, firms incurred the initial cost of building reporting systems. There are also ongoing costs which involve a base level of resource to ingest relevant data and monitor outgoing reports. However, these ongoing costs are not so unduly burdensome on firms that they would indicate a need to undertake a significant overhaul to the rules. UK Finance members would also highlight that introducing any changes to the disclosure regime could create additional costs which should be carefully weighed against the possible benefits.

One area where there may be benefits is in relation to reviewing the requirements regarding in-scope shares (see our response to question 24 below). There are also costs associated with frequent changes to the notification thresholds.

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 reversing the threshold to 0.2%? Is 0.2% still too small?**

UK Finance members would support raising the threshold to 0.2% but would caution against the threshold being raised if it is likely to be lowered at a later date by the regulator at short notice (e.g., in times of market volatility), as this would require rapid changes to reporting systems and impose unnecessary costs on firms. If the threshold is increased, sufficient notice should be given to future changes so that market participants can recalibrate their systems accordingly.

14. **Are there other adjustments to the reporting requirements which you would suggest?**

UK Finance members have no other adjustments to the reporting requirements to suggest.

Public Disclosure

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?**

UK Finance members support measures which uphold market integrity and public confidence (including transparency to investors), ensuring that short selling continues to be regulated in a proportionate manner and with appropriate exemptions for market makers.

Many UK Finance members act as market makers and in this capacity the removal of public disclosure requirements would have a limited direct impact on them in terms of having to produce the disclosures. From a user perspective, certain UK Finance members find the disclosed information useful, e.g., in the context of corporate finance advisory activities. For example, if HMT were to decide to remove the current public disclosure requirements, UK Finance members would see merit in publishing information which is useful for some market participants such as anonymised individual positions or, failing that, aggregated net positions.

UK Finance members have observed that other market participants may have been deterred from taking net short positions because of the public disclosure requirements. This suggests that removing public disclosure requirements could encourage the flow of liquidity by removing this deterrent effect to taking net short positions that exceed the public disclosure thresholds.

16. **How do you use public net short position disclosures and how does it support your firm's activity or the market?**

Please refer to our response to question 15 above.

17. **Do the public disclosure requirements contribute to or create any unnecessary barriers to short selling? If yes, please provide details.**

Please refer to our response to question 15 above.

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?**

    Please refer to our response to question 15 above. Please note that amendments to the public disclosure requirements, such as the removal of the names of the position holders, would diminish utility of the data to those that use the information (for example the advisors to corporate issuers).

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?

    Please refer to our response to question 15 above.

Market Maker Exemption

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?**

    UK Finance members note that the current market maker exemption regime in the SSR currently functions well and does not require any fundamental changes. However, there may be some areas where the application process could be streamlined to improve its efficiency.

    For example, it would be beneficial if market makers could benefit from an activity-based exemption rather than having to apply on an instrument-by-instrument basis. UK Finance members believe that it would be more efficient for the notification process to operate such that all market-making activities of the relevant firm are exempted once a notification has been made, rather than ISIN-by-ISIN notifications being required which are unduly burdensome for firms and likely also for the FCA.

    Additionally, UK Finance members suggest removing the 30-day notification period which is generally perceived to be unworkable as often market makers will need to start their activities in relation to a new share (e.g., as a result of a corporate action or stock split) within a shorter timeframe.

    In any event, UK Finance members would find it helpful for the FCA to produce a standalone FCA guidance document on the market maker exemption. Currently, the FCA encourages firms to continue to have regard to the ESMA guidelines, subject to certain aspects which have been disapplied, which means that it is difficult for firms to track. A single-source of FCA guidelines would provide a simpler solution and improve readability for the industry. However, we wish to emphasise that we do not believe that this should lead to a change in the substance of the rules/guidance, but merely a consolidation of existing guidance.

    Finally, UK Finance members support equivalence for market maker entities which are not members of UK venues (see also our response to question 24 below).

Emergency Intervention Powers

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?

UK Finance members agree with the FCA having intervention powers in the market, so long as they are used judiciously. UK Finance members support the FCA statement made in 2020:

https://www.fca.org.uk/markets/short-selling/statement-short-selling-bans-and-reporting

'We have rarely imposed our own ban on the short selling of UK shares (although we did take some comparable actions in a few cases during the 2008 financial crisis). We have never initiated a ban under the new powers given to us by the SSR. While we cannot rule out that this will be appropriate in particular circumstances, we set a high bar on imposing any bans. Our focus is on maintaining open markets that operate with integrity. We note that an ability to short sell can contribute to this, including by supporting effective price formation, enhancing liquidity and enabling risk management'.

UK Finance members request that, were the intervention powers to be used, as much notice as possible should be given so that market participants can recalibrate their systems accordingly.

22. Do you think any changes could be made to increase the effectiveness of existing short selling bans?

We do not propose any changes 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)?

UK Finance members currently have in place well established arrangements to comply with the current rules which work well. Accordingly, other than the proposals outlined in this response, we do not propose further amendments, and further caution against changes which will incur additional costs.

Overseas Shares

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?

In principle, UK Finance members would be supportive of simplification of the regime, which currently requires firms to undertake a 'two-step' process to determine whether a share is in scope. First, firms have to determine whether a share is traded on a UK regulated market and multilateral trading facility (MTF). Second, they have to consider whether the share is exempt because it appears on the FCA list of shares for which the primary liquidity is overseas.

Maintenance of a positive list setting out all in-scope shares would simplify this process. The FCA could create a list that would include UK issuers and UK ISINs which are traded on UK regulated markets or MTFs, and certain non-UK issuers (for example Jersey holdcos) which have shares traded on UK regulated markets or MTFs as designated as in-scope by the FCA.

UK Finance members would strongly advocate for any such list to be machine readable, identify in-scope shares by their ISIN, and for the FCA to give appropriate notice to the market in the event of any updates being made to the

list. In introducing this change, firms should also be given sufficient lead-time to adapt their systems to avoid the risk of under-reporting where there are changes to the positive list.

Other considerations

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

We refer HMT to the AFME/ISDA response to this question, which is supported by UK Finance members:

> Some of our members consider that the current prohibition in SSR regime for sovereign CDS could be removed.
>
> In their experience, the current restrictions on sovereign CDS have led to inefficiencies in markets for impacted products. As a consequence of the SSR, there are no natural holders of uncovered in-scope (UK) CDS. Without these restrictions, participants could use UK sovereign CDS as an effective hedge to cover various risks to which they are exposed to in the UK (not only holders of UK sovereign debt). By contrast, in markets outside of western Europe, investors can buy protection through CDS in countries without any short selling restrictions.
>
> For example, an investor that would like protection on the Brazilian economy, or credit quality of Brazil relative to current market pricing, could buy CDS. If the CDS spreads widen, the investor is able sell the CDS to realise profits which would offset losses it may have incurred on Brazil. In the UK (as with other European sovereign CDS covered by EU SSR) it is not possible for market participants to buy uncovered UK sovereign CDS, other than in a market making capacity. Therefore, if UK sovereign CDS spreads widen, there are few market participants to dampen volatility by selling protection to those who require it. As a result, when markets start to widen, there are no market participants realizing profits and therefore swings in UK sovereign CDS prices are exacerbated. A good example of this was seen during Autumn 2022 – UK sovereign CDS moved from 15bp to 55bp in a little over a week and there was an absence of market participants selling protection to dampen the swing, as there were few owners of positions. By way of context, UK sovereign CDS usually trades in a 10-20bp range.
>
> However, if HMT is not minded to remove the existing UK regime for sovereign CDS, we would urge HMT to simply retain the existing regime, rather than to make further amendments. This is because we do not believe that amendment short of removal of the regime would produce meaningful benefits for the market and believe that these would likely be outweighed by the costs and complexity of implementing additional changes.
>
> In relation to the SSR regime for sovereign debt, at this point in time members do not see the need for regulatory change.

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).

UK Finance does not believe fundamental changes are required to the UK short selling regime and proposes only the amendments in this response.

Where the UK is considering any future amendments, potential benefits should be weighed up against costs and complexity incurred by the industry in adapting to any such changes.