

03 March 2023

Short Selling Call for Evidence
Securities and Markets
1 Red HM Treasury
1 Horse Guards Road
London SW1A 2HQ

Submitted by Email: MarketConduct@hmtreasury.gov.uk

Re: December 2022, Short Selling Regulation Review – Call for Evidence¹

Dear Sir or Madam,

At the Standards Board for Alternative Investments (SBAI), we welcome the opportunity to respond to the HM Treasury Call for Evidence on Short Selling Regulation.

The SBAI is a global alliance of alternative investment managers and investors dedicated to improving the alternative investment industry through setting standards², providing industry guidance³, facilitating collaboration and exchange of ideas. Our community includes asset managers with over \$2 trillion in AUM and institutional investors responsible for over \$6 trillion in assets. The SBAI is an Affiliate Member of the International Organization of Securities Commissions (IOSCO), and we support global efforts to facilitate fair and efficient markets, reduce systemic risk and enable investors to make well-informed investment decisions.

We at the SBAI have highlighted in previous regulatory consultations the important role short selling plays in global financial markets and the many benefits it brings to global economies, including investor protection against market volatility, increased liquidity for all market participants, more efficient price discovery, dampening of price bubbles, and ultimately more efficient capital allocation.⁴ In particular, the presence of sophisticated investors such as hedge funds, who invest heavily in information gathering to make well informed investment decisions (including short selling), is particularly beneficial for retail and index investors.

The SBAI agrees that robust regulation of short selling is important to support the proper functioning of markets, in particular, the restrictions on uncovered short selling help to prevent settlement failures. In relation to the EU Short Selling Regulation (EU SSR), the SBAI has previously raised concerns about the public disclosure threshold which is currently set at 50 bps. We believe there is no justification for public disclosure of short positions at such a low threshold from a financial stability, market integrity or investor protection perspective.

¹ [SSR CFE - Official Publication FINAL .pdf \(publishing.service.gov.uk\)](#)

² Alternative Investment Standards: <https://www.sbai.org/standards.html>

³ SBAI Toolbox Guidance: <https://www.sbai.org/toolbox.html>

⁴ Overview of SBAI regulatory consultation responses on short selling: <https://www.sbai.org/regulatory-engagement/short-selling-and-securities-lending.html> (ESMA, European Commission, CESR, IOSCO, UK FSA, SEC)

We also highlight that a more efficient approach to capturing aggregate short selling data would involve sourcing aggregate data from broker-dealers, rather than requiring reporting from all asset managers, significantly reducing reporting burdens and providing more accurate data for the FCA.

Should you wish to discuss any elements of our response we would be more than happy to oblige.

Yours sincerely

Thomas Deinet
Executive Director
Standards Board for Alternative Investments (SBAI)

Responses to Specific Questions⁵

Scope of the Call for Evidence

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

Yes

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

Short selling should be regulated, to ensure the orderly functioning of markets. Specifically, restrictions on uncovered short selling help to prevent settlement failures, which can undermine investor trust in a market place.

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

The SSR puts a disproportionate regulatory burden on short sellers in the UK markets, specifically in relation to regulatory reporting and the public disclosure requirements (as set out in more detail below).

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?

The restrictions on uncovered short selling for investors are essential to prevent settlement failures in situations where more stock is being sold than is available to borrow.

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?

Given that most firms will need to comply with both SSR and the UK regime, modifications to the existing SSR framework will be easier to administer for firms rather than a fundamentally reformed approach.

⁵ Where we have chosen not to answer a question, this should not be considered an endorsement of any or all the suggestions contained in that question.

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

In general, regulatory frameworks that do not introduce public disclosure at low thresholds maintain a higher incentive for market participants to gather information about security specific issues and prevent copy-cat trading as well as short squeezes, to the benefit of price formation and stability of the marketplace. In the US, for example, there is no public disclosure of short positions by individual market participants under current law. Only aggregated short interest data is reported publicly.

In addition, data collection from brokers-dealers or exchanges (as is the case in the U.S.) is more cost efficient and accurate than collecting the data from individual managers, hence, consideration should be given to adopting such a framework (see response to question 19.).

We would also like to make the following additional suggestions:

- Harmonisation of double listing rules between the UK and EU will reduce complexity and cost
- Manual filing (EU, UK) is cumbersome and prone for error: Instead, there should be a harmonised XML format that can be filed through an API / File Transfer Protocol.
- There should be a single source for shares in scope of the disclosure regulation and aggregate outstanding share capital information to make the calculation of ratios easier. The Dutch AFM for example provides a register of issued capital⁶

Restrictions on 'uncovered' short selling

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

Yes.

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?

The locate arrangements with banks are well established and work well, settlement issues are exceptional for buy-side firms. We understand from practitioners that variations exist regarding the stability of "locates", mostly driven by the maturity of markets, but this is not a matter for further regulation.

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?

No, there is no evidence that short selling activity is causing settlement failures.

Position Reporting to the FCA

10. Should the FCA specifically monitor short selling?

Yes. But the private reporting thresholds do not need to be as low as 10 bps.

⁶ <https://www.afm.nl/en/sector/registers/meldingenregisters/geplaatst-kapitaal>

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

Comfort is derived by investors from the ban of uncovered short selling, reducing the risk of settlement failures. We have not seen evidence that market participants specifically take comfort from the FCA market monitoring of short positions.

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?

The SBAI is not an asset manager submitting short selling information, but we understand from signatories to the SBAI Standards that the reporting cost are significant, due to a) the low reporting thresholds (frequency of reporting), b) divergences between jurisdictions/regulators, c) complexities when multiple short selling regimes apply to the same issuer, and d) the time consuming manual upload by issuer (see suggestions in response to question 6.).

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?

Current reporting thresholds and increments are set too low: Shorting pressures on a stock from an individual short position of 10bps or 20bps are unlikely to have material relevance from a monitoring or risk perspective. In this context, it is worthwhile clarifying for FCA and HM Treasury which “risks” are being monitored in this context (market abuse, systemic risk, ...).

For example, in relation to **prevention of market abuse** (e.g., spreading rumours), investigative powers for regulators already include information access in relation to both long and short positions, so it is not clear if a short position reporting framework with low reporting thresholds is needed if is not deemed relevant for long positions.

In relation to **system wide risk**, we have not seen any evidence that short position information matters.

A more efficient approach to capturing short selling information would involve collecting aggregate short selling data from the broker-dealers (instead of individual managers), significantly reducing the data reporting cost imposed on the overall industry and providing more accurate information, given that short positions which are below the reporting threshold will also be captured (see answer to question 19).

Alternatively, the reporting threshold should be increased to at least 50 bps, with additional reporting in 20 bps increments, and reporting timelines to be extended to T+4 (in line with major long shareholding reporting).

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

No comment

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?

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.

There is no rationale for public disclosure of short positions of individual investors from an investor protection, financial stability, market integrity or efficiency perspective (see more details in response to question 18.).

Some firms do monitor public net short position disclosure to gain insights into the positions/views of competitors, thereby benefitting from the information acquisition of others, and reducing the competitive advantage a competitor might obtain from investing in investment research.

If public disclosure requirements were to be removed, investors would be more willing to invest in research and to enter into short positions exceeding 50 bps without being exposed to the risk of short squeezes and copy-cat trading. This would enable investors to better manage and hedge risk, as well as express (negative) views on issuers through their short positions in excess of 50 bps. This will contribute to liquidity in markets and better price formation.

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?

It is unclear what informational value the public disclosure of individual "short sales" with or without the identities of the position holders provides. In the past, regulators including the UK FCA⁷ have referred to the benefits of enhanced transparency that short selling conveys a signal to markets that a firm is overvalued, however, we disagree with this assessment: On every short sale, there is a buyer, signalling to markets that the stock is undervalued. Therefore, the "net signal" is actually not indicative at all of whether the stock is over or undervalued. In addition, short selling is used in hedge transactions, where only the relative directional movement of a shorted stock matters (in relation to the respective long position), irrespective of whether the market rises or falls.

Therefore, we would argue that all information is reflected in today's market price, irrespective of whether short selling has occurred or not. The aggregate impact of short selling might have reduced that price, but thereby this information is included in today's market price.

Portraying that short selling activity is a signal to other investors that a stock is overvalued is only true under the assumption that the parties short selling the stock have better information than those buying the stock. If some investors assume that mostly hedge fund managers engage in short selling and that hedge fund managers have better information, then they might give more weight to the fact that short selling occurs (rather than just assuming that today's price is the best estimate of future value).

⁷ See UK FSA's Discussion Paper on Short Selling (DP09/1) – (5.7)

The problem arises if regulators now argue that short selling can convey a signal, because they implicitly tell market participants that short sellers indeed have better information, and thereby encourage herding behaviour based on short selling disclosures. This perspective is also misguided because it ignores the fact that many short sales by hedge fund managers (and others) are motivated solely by hedging and might not reflect any particular fundamental view on the value of the stock.

We believe that it would be an arbitrary decision to enhance disclosure of short positions on the grounds of “additional valuable information” and that this might lead to market distortions/less efficient price discovery. It is worth noting that there is no disclosure requirement of long positions at low thresholds.

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?

Broker-dealers have access to short position data, (as is the case in the U.S.⁸), so even if every investor remained below the reporting threshold, regulators could still obtain the aggregate short sale data from the broker-dealers and choose to make it available. Periodic aggregate data collection from a small number of broker-dealers would be far more efficient than recording every single short position (and variation thereof) above a certain threshold from investment managers. Given that broker dealer reporting would also capture those positions that fall below the reporting threshold, it will give a more accurate picture of aggregate outstanding short positions.

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?

No comment.

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?

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)?

The SBAI agrees that the UK authorities should have tools to combat market abuse and maintain orderly markets, but it is important that the well-meant measures the authorities deploy do not become the source or amplifier of disorderly markets, preventing the price formation process from happening and, in fact, undermining confidence in markets. The SBAI has therefore in the past cautioned regulators’ expectations with respect to the effectiveness of market interventions with the aim of restricting short selling.⁹ Indeed, such interventions can have a more devastating impact, since it can give rise to concern by investors about the efficiency of the price

⁸ In the U.S., exchanges disclose the aggregate level of short exposure on a monthly basis, based on short flags when trading. FINRA collects short sell data from brokers twice a month (private).

⁹ See SBAI responses to FSA DP09/1: <https://www.sbai.org/resource/sbai-comments-on-fca-cp-on-short-selling.html>

formation process (i.e. investors assuming markets are overvalued because short selling is banned), and thereby trigger further sell offs of those who would otherwise hold on to their assets.

It is difficult to envisage situations where such powers should be deployed, hence we agree that these powers should be reserved for exceptional circumstances, anchored in a rigorous process for identifying disorderly markets to prevent unjustified short selling bans, which undermine the confidence in the markets and can amplify disruption.

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?

No comment.

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.

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).

No comment