March 2023

UK Equity Markets Association (UKEMA)

UKEMA Response to the Short Selling Regulation Review - Call for Evidence

The UKEMA welcomes the opportunity to respond to HM Treasury's "Short Selling Regulation Review – Call for Evidence". The UKEMA represents those investment banks and equity brokerage firms that focus on raising capital for SMEs and small and mid-cap quoted companies. Its members trade in the shares of over 2,000 quoted companies, accounting for 57% of London Stock Exchange turnover by volume, and produce research on over 1,700 companies, representing 87% of listed issuers. UKEMA member firms facilitated investment of more than raised £6.7bn in funds for companies in 2021, supporting growth in the real economy, employment, innovation, entrepreneurship and wealth creation.

Summary

We note that the Government's aim, as set out in the ministerial foreword to the Call for Evidence, is to design a short selling regulation that is tailored to the needs of UK markets, companies and investors and we very much agree with that aim. As set out above, our members are investment banks representing SMEs and small and mid-cap quoted companies. Our main focus in relation to short selling is therefore making the regulation work in a more proportionate manner for smaller investment banks that do not have large compliance departments and in addition, to make it less burdensome for all market participants. Accordingly, our key points are set out below, noting that we do not intend to reply to the questions individually.

- The disclosure regime should be re-set in terms of timings and percentage thresholds and should mirror that for long positions.
- We agree that market makers should be exempt from the disclosure regime but the notification regime should be abolished as market makers should be able to rely on their registration as market makers

Key points

Disclosure requirements

As set out in the UK Short Selling Regulation ("SSR"), net short positions in companies quoted on a regulated market or MTF of over 0.1% must be reported to the Financial Conduct Authority (FCA). Public disclosure is required if the net position exceeds 0.5%. In both cases, incremental changes of 0.1% must be reported.

This contrasts with the position relating to long positions set out in DTR5 which requires disclosure when a position reaches, exceeds or falls below 3%, 4%, 5%, 6%, 7%, 8%, 9%, 10% and each 1% threshold thereafter up to 100% for UK issuers and in the case of non-UK issuers on the basis of thresholds at 5%, 10%, 15%, 20%, 25%, 30%, 50% and 75%. Long positions are calculated by reference to voting rights but can refer to both direct and indirect interests.

In relation to timing, the SSR requires disclosure by 3.30pm on the trading day after the day the position was reached whereas DTR5 requires disclosure to both the company and the FCA within two trading days in the case of UK companies and four trading days in the case of non UK companies. The company must then report the notification to the market by the end of the trading day following receipt of the notification.

In the case of both the percentages and the timing, it isn't clear to our members why the two regimes are so different. We note the arguments for and against short selling set out at paragraphs 1.3 and 1.4 of the Call for Evidence, however, our view is that short selling is beneficial to the market and particularly to liquidity. Further, we believe that any requirements on market participants should be proportionate and not overly burdensome.

Whilst we acknowledge that the disclosure regime was initially introduced from a public policy perspective in order to avoid market participants being unaware of short positions being taken, we do not think that a disclosure threshold at 0.5% is proportionate. A net position of that size is, in our view, not material enough to create the negative feedback loop that HM Treasury wish to guard against. It is also not clear to us why the time period to disclose short positions should be any different from those for disclosing long positions.

Both long and short disclosure regimes seek to provide additional information to those trading in relevant securities so they can make informed trading decisions based not just on the prevailing market conditions but also on information about material long and short positions. Trading dynamics are already visible through market prices and trade transparency. By having inconsistent disclosure regimes for long and short positions, this can result in a distorted view of the market, because short position disclosures are required at lower percentage levels than long position disclosures and this may effectively discourage net short selling activities at levels above the threshold. As a result, this could lead to market prices which do not accurately reflect true market sentiment/demand and supply.

Our members think that the two regimes should be aligned and that in particular the disclosure thresholds set out in the SSR should be set at the more material levels required for long positions and, equally, incremental changes should only be disclosed when the position goes through a whole number percentage. We suggest these changes because, in our view, the very low disclosure thresholds effectively discourage short selling activity and we see that result as unhelpful given the importance of short selling being available as a legitimate activity to help price formation.

Exemption for market makers

As set out at paragraphs 2.14 of the Call for Evidence, there is currently a notification regime for market makers which allows them to be exempt from the disclosure regime and the restrictions on uncovered short selling. This means that if a notification is submitted to the FCA in writing using a prescribed form at least 30 calendar days before the firm intends to rely on it and provided that the market maker is not then prohibited by the FCA from relying on the exemption, the exemption for market makers can be used. The form requires a list of financial instruments to which the exemption relates to be attached to the form, meaning that in practice a new form and a new 30 day period needs to start if the firm wishes the exemption to apply to new securities. In the experience of our members, the current regime is very onerous given the time it takes to fill in each form and the administration that is involved. Given that market makers are already required to be registered as market makers for each relevant security we do not think that this additional level of bureaucracy or administration is required and that the notification regime should be abolished as it is difficult to see what purpose it serves. Instead market makers should be automatically exempt from the disclosure requirements.

Uncovered short positions

The SSR bans uncovered short selling by requiring all persons entering into short selling transactions to have the position covered. We suggest that allocations in a capital raising before those securities have been settled should be permitted cover even if there are conditions to the allocation such as admission to trading. This is not currently the case.