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Updated draft of the Short Selling Regulations 2024 published

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On 22 November 2023, an updated draft of the Short Selling Regulations 2024 was published. It provides greater detail on the United Kingdom government's plans to reform the short selling regime and forms part of an ongoing consultation process on the subject. The government plans to legislate on short selling in 2024.

Short selling has been regulated in the United Kingdom (UK) since 2012 as part of the regulatory reforms introduced by the European Union (EU) in response to the 2008/09 financial crisis. The aim of regulating short selling was to increase transparency of short positions held in certain EU securities, reduce settlement and other risks related to naked short selling and to grant Member States clear powers to intervene in the market to preserve financial stability. The draft Short Selling Regulations 2024 (Draft SSR) represent an important part of the government's post-Brexit regulatory reform agenda, the aim of which is to replace EU-derived rules and regulations with rules set by the UK's financial services regulators within a framework established by Parliament.

Overview of the review process

The Financial Services and Markets Act 2023 (FSMA 2023) will over time repeal most retained EU laws pertaining to financial services. The government's objective has been to replace retained EU rules with a new regime that is tailored to the UK's policy aims. Following the end of the Brexit transitional period, the UK rules on short selling are contained primarily in retained EU regulations; specifically, Regulation (EU) No 236/2012 on short selling and certain aspects of credit default swaps (UK SRR) and Commission Delegated Regulation (EU) No 918/2012. These regulations were incorporated into UK law by the European Union (Withdrawal) Act 2018 and subsequently amended by secondary legislation. The Financial Conduct Authority (FCA) has also issued technical guidance on the interpretation of the amended regulations.

The government published a Call for Evidence on the Short Selling Regime in December 2022. In its July 2023 response to the submissions received, the government discussed its plans to revise the UK rules on short selling. A parallel consultation process was also initiated by the government concerning short sales of sovereign debt and credit default swaps (CDS).

In November 2023, the government published the Draft SSR and its related policy notes, providing additional detail on its approach to various topics raised in the consultation process. The government also published its response to the consultation on the short selling of sovereign debt and CDS.

Key reforms in the Draft SSR

- **Short selling brought into the Designated Activities Regime (DAR):** FSMA 2023 introduced the DAR to support the process of repealing EU law and introducing new UK regulations. The DAR enables the FCA to create rules applicable to non-authorised and non-financial businesses. HM Treasury has a wide discretion in determining the range of activities covered by the DAR. The Draft SSR states the DAR is to include: (i) entering into a short sale of a share; and (ii) entering into a transaction which creates or relates to a financial instrument where an effect of the transaction is to confer a financial advantage on the person entering into that transaction in the event of a decrease in the price or value of a share. For more information on the new DAR, please read our client update on the Financial Services and Markets Act 2023 here.
- **FCA will publish aggregated net short positions:** the FCA's current approach is to disclose the net short positions of individuals where the size of the position exceeds 0.5% of issued share capital in a company traded on a UK trading venue. The government's review process considered whether this approach was discouraging firms from taking net short positions in their portfolios due to concerns with those positions being publicly disclosed. Consequently, the Draft SSR mandates that the FCA publish aggregated net short positions each working day without identifying the individuals holding the short position.
- **FCA notification threshold returns to 0.2%:** As a result of the market volatility during the COVID-19 pandemic, short sellers were required to notify the FCA when their net short positions in a company was equal to or greater than 0.1% of the company's issued share capital. The Draft SSR reintroduces the pre-pandemic notification threshold of 0.2% of issued share capital.
- **Changes to the exemption regime:** At present, particular types of shares are subject to an exemption from UK short selling regulations if their principal trading venue is located in an overseas jurisdiction. This exemption is only available if the shares are mentioned on a list maintained by the FCA. In response to views that a "positive" list of shares covered by the UK short selling regulations would be more useful for the market, the Draft SSR adopts this approach and moves away from the "negative" exemption-based list currently in force.
- **Easing of restrictions on short selling UK sovereign debt and UK CDS:** HM Treasury also issued a response to the consultation on short selling issues related to sovereign debt. The government stated that the current restrictions and reporting requirements on short sales of UK sovereign debt and uncovered CDS would be withdrawn. The Draft SSR is consistent with this approach and no restrictions are described. However, the FCA will continue to have power to intervene in exceptional circumstances.

Timing

HM Treasury is in the process of considering technical comments on the Draft SSR. The government intends to legislate on the matter in 2024. The Draft SSR is expected to come into force at or around the same time as new FCA rules on short selling, the repeal of the UK SRR, and related legislation.

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If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

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