



## A) Introduction

The **Association of Corporate Treasurers (ACT)** welcomes the opportunity to comment on the publication in December 2022 of HM Treasury's (**HMT**) *Short Selling Regulation Review Call for Evidence ("the Consultation")*:

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We acknowledge that some of the policy concerns we highlight in this response, as having relevance to corporate treasurers, may have been mentioned within the Consultation itself.

The ACT notes the detailed questions but has chosen to respond to this consultation at a high level and offers to engage in further discussion with the UK authorities, as they consider any potential policy changes for the Short Selling Regulation ("**the regulation**"). The ACT's focus is upon the potential impact of any dilution of the current regulation upon non-financial corporates (sometimes referred to as "the real economy"). We acknowledge that the current regulation seeks to mitigate systemic risks by striking an appropriate balance between the competing interests of different categories of market participants. We hope that any future reforms of the regulation shall continue to provide robust safeguards for corporate issuers of securities and for long term investors. A potential relaxation of the UK short selling regulation, as envisaged by HMT, may provide new opportunities for certain categories of investors in the UK financial sector, such as hedge funds, but it may undermine the attractiveness of a UK listing to non-financial corporates and longer term may be detrimental for UK growth and competitiveness in the non-financial sector.

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## B) Background

The ACT, a non-political organisation, is the only professional treasury body with a Royal Charter. For over 40 years we have set the global benchmark for treasury excellence; we lead the profession through our internationally recognised qualifications, by defining standards and by championing continuing professional development. We are the authentic voice of the treasury profession representing the interests of the real economy and educating, supporting and leading the treasurers of today and tomorrow. Treasurers are typically the individual responsible for financing their companies' balance sheets, for managing financial risks and for inter-acting with financial firms.

We infer that references to "firms" in the Consultation typically mean financial firms rather than corporates. As such it would be helpful if future policy consultations could make a clearer distinction between the benefits accruing respectively to financial firms and non-financial corporates.

In general, whilst the ACT has canvassed its members in developing this response, the Short Selling Regime *as currently enacted* is not a priority concern for most corporate treasurers in the present economic climate and this consultation paper appears to have received more input from short-sellers than from those whose shares may be short-sold. At the present time, as many businesses struggle to recover from the pandemic and the impact of high inflation and to understand the divergence of UK and EU regulations post-Brexit, we believe that a review of the short selling regime would not be considered a priority by a majority of corporate treasurers. As a result there may be further unintended consequences for the real economy not yet identified.

### C) High Level Responses to the UK Consultation

Within that caveat, we consider that **key areas of concern for corporate treasurers** are:

- a) It is unclear whether the present 'call for evidence' will give rise to formal proposals from HMT (or FCA) that in turn shall be subject to formal consultation, and how corporate treasurers may engage in this process, and upon what timelines. As mentioned above, changing (by diluting) the current rules is seen as neither a priority nor desirable by corporate treasurers. The onus is on those seeking to promote short-selling to provide clearer evidence to justify any dilution of the current rules.
- b) We do not have any evidence to support the assertion in the consultation that *"short selling supports the functioning of markets and enables firms to raise funds"*. Speculative short selling may enhance the profits of certain financial firms and increase the volume of market transactions but it may hinder individual non-financial firms (corporates) from raising funds at a time of need, because it can amplify downward movements in their market capitalisation.
- c) We would agree with the observation on the UNPRI web site (from 2021) that: *"some might argue that if shorting a company generates a profit, your interest is not necessarily aligned to seeing that business improve the very things that have attracted the short position in the first place"*.
- d) It has been said that *naked* short selling was detrimental in the global financial crisis (see Section D below) and therefore we would strongly advocate a continuation of only permitting *covered* short selling.
- e) Short-selling is potentially open to risk of market abuse. For example, if a short position is held, further high frequency trading of very small parcels of equities may drive down a price such that it falls below the levels that trigger algorithmic models to sell larger holdings (that were being held by long-only investors), creating a downward spiral. In this scenario, the high frequency trading (selling of small parcels) would not necessarily fall within the short selling rules but would be motivated by the open short position.
- f) However, where such transactions could be linked to other news or market events, it may be difficult for regulators to monitor transactions unless there are tight disclosure rules in place. Therefore we would be reluctant to see any loosening of the disclosure requirements, including current transparency around the names of individual short-selling firms. The protection of the UK real economy and long-term investors (including pension funds) should rank higher than the protection of short-selling speculators.
- g) Whilst it would seem perverse to abolish or water down the obligations on short-sellers to report, we can see some merit in the argument for reverting to pre-pandemic reporting thresholds, representing the previously established balance of interests in 'normal' markets.
- h) In general terms, corporate treasurers would support the important role of the FCA in monitoring short selling to ensure an orderly market.
- i) The references in the consultation to Overseas equities do not make clear the future status of dual-listed equities, which may apply to a number of multinationals listed in the UK and elsewhere.
- j) Many corporates still sponsor Defined Benefit pension funds for whom securities lending (which facilitates covered short-selling) may be advocated by some advisors as an opportunity to gain additional return from long term holdings but which in reality constitutes a bet against the pension fund's own investment decisions. A similar concern may exist for charitable foundations and whether securities lending to short-sellers is fully consistent with the trustees' duty to safeguard their charitable assets.

- k) The consultation refers to a claimed benefit of short selling in rooting out fraud. We do not have any particular evidence to support or deny this assertion, which may be achievable through other means than short-selling. Nevertheless, we are open to the argument that short-selling may have some indirect market benefits (under current rules) for liquidity and to aid price discovery. *(please refer to the comments on ESMA study in Section D below).*
- l) In general terms, a future divergence of UK and EU rules is not necessarily helpful in this instance for non-financial corporates, when such divergence increases the multiplicity of applicable regulations (for multinationals) without a clearer benefit to the UK real economy.

## D) Evidence of the Impact of Short-Selling

We believe that any changes to the current regulation(s) should be based upon consideration of empirical evidence of the systemic risk posed by short selling, and not be driven by opportunities for speculative profits.

As acknowledged in paragraph 1.8 of the consultation, the current Short Selling Regulation entered into force in November 2012 with the aim of creating a common regulatory framework regarding the requirements and powers with respect to short selling. The need to establish such common regulatory framework emerged in the aftermath of the 2008-09 financial crisis, where EU Member States (then including the UK) adopted highly diversified measures to restrict or ban short selling as **“such practice could aggravate the downward spiral of shares’ prices and lead to systemic risks”**. The stated *“objectives of this short selling legislative framework [were] to increase transparency of short positions held by investors in certain EU [then including UK] securities, reduce settlement and other risks linked with uncovered or naked short selling and create a harmonised framework for coordinated action at European level.”*

In contrast, we find it curious that the HMT consultation paper asserts that [para 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”*. We would respectfully disagree with this assertion, whilst not wishing to pre-judge the outcome of HMT’s own call for evidence.

We note the UK/HMT consultation follows on from the EU/ESMA Review of certain aspects of the EU Short Selling Regulation 21 September 2021 in which ESMA undertook a systematic review of the provisions of the EU regulation in light of (i) the COVID-19 crisis and (ii) the episodes of high volatility which took place in the US markets and elsewhere in respect of the so-called “meme stocks”, and ESMA considered the possibility of similar phenomena developing in European markets. The ESMA impact analysis of the long-term bans adopted during the first wave of the COVID-19 pandemic in 2020 noted that, since the data used in the analysis are encompassing the years 2019 and 2020 [i.e. before the end of the Brexit transition period] and the amount of trading activities in the UK allow for increasing accuracy of the analysis during the matching process, **UK shares were included** in the matching process and in the regressions as a control group.

The conclusions of the ESMA impact analysis were that the European long-term bans of 2020 had mixed effects, since they entailed a deterioration of market liquidity but also diminished the volatility of the concerned shares. ESMA was of the view that the restrictions can contribute to preventing .... disorderly downward price spirals .... [and] ... that those impacts were particularly relevant in the context of the stressed market conditions with limited accurate and reliable information experienced after the COVID-19 outbreak. Therefore, ESMA considered that the current framework supported [Regulators’] capacity to address concerns on financial stability and should therefore remain available ... in case of developments impacting the resiliency of financial markets. (It was additionally noted that the overall framework would benefit from some operational improvements).

Given that the ESMA study included some UK data, it would be helpful to publish the evidence upon which the HMT analysis is based in the event that HMT were to reach different conclusions as to the efficacy of restricting short selling.

## E) Next Steps

As mentioned, we shall be happy to engage in further discussion as the UK regulatory responses are developed. In the first instance, please contact our Policy & Technical team:

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### ***About the Association of Corporate Treasurers***

*The ACT is a professional body for those working in corporate treasury, risk and corporate finance. It is established by Royal Charter in the public interest. Further information is provided on our website: [www.treasurers.org](http://www.treasurers.org)*