Title: The Short Selling (Notification Threshold) Regulations 2023 **SI (Statutory Instrument) No:** 2023/1258 **Other departments or agencies:** Financial Conduct Authority **Contact for enquiries**: Charlie Graham (charlie.graham@hmtreasury.gov.uk)	De minimis assessment **Date: 27/11/2023** **Type of regulation: Domestic** **Date measure comes into force: 05/02/2024**
Benefit of Preferred (or more likely) Option £1,127,000 – £1,246,200	**Equivalent Annual Net Direct Cost to Business per year** £112,700 to £124,600 net savings

1. What is the problem under consideration? Why is government intervention necessary?

Short selling is the practice of borrowing a security and selling it at the current market value with the expectation that the price is going to fall. The intention is for the short seller to repurchase the security for a lower price, at a later date, and to make a profit from the difference after returning the securities to the lender.

The government sees short selling as an essential tool to facilitate effective market functioning. It supports liquidity, risk management and effective price discovery. However, the government recognises that there can also be risks associated with short selling, which can impact on wider market confidence. For this reason, the UK has a regulatory regime for short selling, the Short Selling Regulation (SSR), which is a piece of retained EU law, to facilitate short selling and the benefits it provides to orderly and effective market functioning, while protecting against risks.

The Chancellor's Edinburgh Reforms, announced on 9 December 2022, set out a package of changes to drive growth and competitiveness in the financial services sector. As part of this, the government launched a Call for Evidence on the SSR. The Call for Evidence asked for feedback on the core elements of the SSR, to understand how the regime could be reformed to make it work better for UK markets. In July 2023, the government published its response to the Call for Evidence.

One of the areas on which the Call for Evidence sought feedback was the current position reporting requirements under the SSR. Under the SSR, persons with net short positions of 0.1% or more of the issued share capital of a publicly traded company are required to report these to the Financial Conduct Authority. A net short position is the position remaining after deducting any long position that a person holds from a short position. These thresholds are set as a proportion of the total issued share capital of the company. Feedback in response to the Call for Evidence highlighted that the reduction in the reporting threshold from 0.2% to 0.1% during the Covid-19 pandemic has led to a significant increase in the number of reports firms are required to submit to the FCA. Firms are currently required to manually input individual position reports into the FCA's reporting portal, meaning there is a per report cost of reporting. The lowering of the threshold from 0.2% to 0.1% of issued share capital has significantly increased the number of reports firms are required to submit, resulting in a regime that is more burdensome on reporting firms.

2. What are the policy objectives and the intended effects?

The objective of notification requirements under the SSR is to give the FCA visibility over short selling activity in the market. The FCA uses position reports to identify companies subject to net short positions and persons who have net short positions in those companies. This information, alongside other information it receives, enables the FCA to track net short positions in the market and to proactively engage with firms to address how their net short positions and related trading activities are impacting on the market. The engagement also helps the FCA identify possible misconduct by companies.

While FCA monitoring of short selling activity is important to support market integrity and market confidence, it is also important that the UK's short selling rules do not place a disproportionate burden on reporting firms. Based on the feedback received in response to the Call for Evidence, the government announced that it would revert to the previous 0.2% reporting threshold, on the basis that this threshold strikes a better balance between providing the FCA with sufficient data to carry out its functions, and appropriate burdens on reporting firms. This instrument makes this change to the reporting threshold. To note, this SI only makes a change to the notification threshold and does not make changes to how market participants can short sell, for example to restrictions on uncovered short selling.

3. What policy options have been considered, including any alternatives to regulation? Please justify preferred option

<u>Preferred option: increase notification threshold to 0.2%</u>

As mentioned above, the 0.1% threshold has led to a significant increase in the number of reports firms are required to submit. The feedback to the Call for Evidence highlighted several ways in which the reporting regime imposes burden on reporting firms (listed on pages 11 and 12 of the government response to the Call for Evidence[1]). The Treasury is empowered under the SSR to change the notification threshold via Statutory Instrument. Based on feedback received the government considers changing the threshold to be the most effective way to reduce burden associated with the regime.

The Treasury is separately replacing the SSR with a UK-tailored regime. As set out in the draft Statutory Instrument, the Treasury is proposing to give the FCA a rulemaking power to set out other aspects of the net short position notification regime. The FCA will consult on its rules in due course and will take other feedback provided in response to the Call for Evidence on the net short position notification regime into account.

<u>Alternative option 1: do nothing</u>

Without legislative change, firms in scope of the SSR would have to continue reporting net short positions to the FCA once they cross the lower 0.1% of issued share capital reporting threshold. As highlighted in response to the Call for Evidence, this has led to a significant increase in the number of reports firms are required to submit to the FCA. Alongside other factors, such as the current deadline for reporting and the FCA's operational arrangements for reporting, this 0.1% threshold has placed a disproportionate burden on reporting firms.

[1] Short Selling Regulation Review - Government response 1.pdf (publishing.service.gov.uk)

Alternative option 2: keep 0.1% threshold, consider other changes to reporting regime

As mentioned above, in addition to increasing the notification threshold, respondents to the Call for Evidence suggested further changes to the SSR reporting regime to lessen the burden on reporting firms, such as extending the deadline for reporting to the FCA or improving the FCA's operational arrangements to streamline the notification process. However, the government's view is that these changes on their own would not go far enough to appropriately reduce burdens associated with short selling reporting requirements, as while they would likely reduce the cost associated with individual reports, they would not significantly reduce the overall volume of reporting.

4. Please justify why the net impacts (i.e., net costs or benefits) to business will be less than £5 million a year.[2]

This instrument means that firms will only have to report net short positions to the FCA if they meet the threshold of 0.2% of issued share capital, rather than 0.1% of issued share capital. This will impact all firms who have a net short position in a share in scope of the SSR if this position, particularly where this position is between 0.1% and 0.2% of issued share capital. Based on figures provided by the FCA, in 2022, around 400 firms submitted at least one net short position report to the FCA.

Costs

Based on feedback from reporting firms, this change will have a one-off implementation cost to update their reporting systems, but an ongoing cost saving by way of the lower volume of reports they expect to be required to submit.

Based on outreach to a number of trade associations, costs to firms to implement this change are expected to be minimal. Firms expect this change to take between 5 minutes of 1 employee to 16 hours of 1 employee. Based on average salary estimates for a financial services professional working in operations, this equates to a one-off cost of £2 – £300 per firm. Aggregated across the estimated 400 reporting firms, this equates to an estimated total cost to business of £800 – £120,000.

Benefits

The cost saving of increasing the threshold to 0.2% of issued share capital will vary by firms depending on the volume of reports they are required to submit. Reporting IT systems are already in place, meaning that the main variable cost is the amount of time spent by a firm's compliance staff to calculate, verify and report net short positions to the FCA. From engagement with trade associations, the current process for notifying the FCA takes around 15 minutes on average per report.

In a small number of cases, reports may require more extensive due diligence, which in turn may exceed this 15-minute estimate, in some cases taking several hours. These cases are hard to quantify but based on feedback do not represent a significant proportion of reports. As it is hard to quantify the precise number of cases, and the resources required to undertake this extensive due diligence may vary significantly, this Impact Assessment does not seek to quantify the cost saving associated with a reduction in these more time-consuming cases as a result the change in threshold.

[2] Figures rounded to the nearest 100

As the notification threshold was reduced from 0.2% to 0.1% of issued share capital in 2020, it is possible to estimate the change in total report submission volumes by comparing 2019 and 2022 submission volumes.

On that basis, this change is estimated to reduce the number of reports firms are required to submit by approximately 50%, or roughly 23,300 reports. Based on the estimated average salary of a financial services compliance officer, this equates to an estimated annual cost saving of £124,700 per year in salary costs. The standard appraisal timeframe for an Impact Assessment is 10 years, meaning that the overall ongoing gross cost saving is estimated to be approximately £1,247,000. To note, these are estimated average cost savings, and will likely vary significantly per firm depending on the volume of reports a firm is required to submit.

Subtracting estimated costs from the benefits yields an overall net direct benefit to business of £1,127,000 – £1,246,200, or an estimated annual net direct benefit to business of £112,700 – £124,600.

Total benefit over 10 years	£1,247,000
One-off cost	– £800 to £120,000
Net direct benefit to business	£1,127,000 to £1,246,200
Estimated annual net direct benefit to business	£112,700 to £124,600

5. Please confirm whether your measure could be subject to call-in by BRE (Better Regulation Executive) under the following criteria. If yes, please provide a justification of why a full impact assessment is not appropriate:

a) **Significant distributional impacts (such as significant transfers between different businesses or sectors)**
No

b) **Disproportionate burdens on micro, small, and medium businesses (below 500 employees).**
No

c) **Significant gross effects despite small net impacts**
No

d) **Significant wider social, environmental, financial or economic impacts**
No

e) **Significant novel or contentious elements**
No

Sign-off for de minimis assessment: SCS

I have read the de minimis assessment and I am satisfied that it represents a fair and proportionate assessment of the impact of the measure.

SCS of Securities and Markets team

Signed: ***Tom Duggan*** Date: 27/10/2023

SCS of Better Regulation Unit

Signed: ***Phil Witcherley*** Date: 01/11/2023

Sign-off for de minimis assessment: Minister

I have read the de minimis assessment and I am satisfied that it represents a fair and proportionate assessment of the impact of the measure.

Signed: ***Bim Afolami, Economic Secretary to the Treasury*** Date: 20/11/2023