Managed Funds Association
The Voice of the Global Alternative Investment Industry
Washington, D.C. | New York | Brussels

February 28, 2023

Securities and Markets
1 Red HM Treasury
1 Horse Guards Road
SW1A 2HQ

Re: Call for Evidence on the Short Selling Regulation Review

Dear Sir/Madam,

Managed Funds Association ("**MFA**")[1] commends HM Treasury for launching its Call for Evidence ("**CfE**") on the UK's Short Selling Regulation ("**SSR**") Review. The launch of the SSR Review is a critical step toward strengthening the UK's dynamic and attractive international financial services centre. A fundamental overhaul of the UK's regime for short selling is not needed; however, targeted modifications to the current rules would reinforce the efficiency of capital markets and unlock greater investment across the UK. Evidence-driven reforms would better underpin the essential role that short selling plays in promoting healthy and effective capital markets.

Short selling benefits the market and investors in a number of ways, including by:

- Improving efficiency of price formation;
- Improving market liquidity and reducing volatility;
- Allocating capital more efficiently and unlocking capital investment;
- Detecting corporate fraud;
- Promoting environmental, social, and governance ("ESG") goals; and
- Reducing risk of market bubbles.[2]

Individual Firm Public Disclosure of Short Positions

Unfortunately, these benefits are constrained by the existing regulatory framework.[3] Short selling, as a tool, is not being used to its full potential in the market and institutional investors like pension funds,

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[1] MFA represents the global alternative investment industry and its investors by advocating for regulatory, tax, and other public policies that foster efficient, transparent, and fair capital markets. MFA's more than 150 member firms collectively manage nearly £2.1 trillion across a diverse group of investment strategies. Member firms help pension plans, university endowments, charitable foundations, and other institutional investors to diversify their investments, manage risk, and generate attractive returns over time. MFA has a global presence and is active in Washington, London, Brussels, and Asia.

[2] These benefits can be explored further in MFA's Short Selling White Paper: https://www.managedfunds.org/wp-content/uploads/2022/04/Short-Selling-White-Paper.pdf.

[3] While this response comments on the UK's SSR, MFA notes that many of the concerns we raise also apply to the EU's identical SSR. We note that the SSR was debated and agreed during the extremely politically charged

university endowments, and charitable foundations are losing out. While the SSR framework, adopted in 2012, does not need a complete overhaul, there is one fundamental shortcoming present in the UK and other jurisdictions with detrimental effect to the markets and investors: individual firm public disclosure of net short positions ("IFPD"). IFPD has multiple negative effects on capital markets, including:

- **Chilling effect:** IFPD has a chilling effect on short selling which reduces the efficiency of price discovery in the market. Firms are understandably reluctant for the market to know their short positions for risk of divulging strategies or becoming susceptible to short squeezes and issuer retaliation. Evidence shows that there is clustering below the IFPD threshold.[4]
- **Herding behaviour:** When firms do execute short sales above the IFPD threshold, this causes herding behaviour in the market. Other market participants who have not conducted careful research on an issuer will frequently copycat the disclosing firm's short position. To that end, herding behaviour risks exaggerating price adjustments and exacerbating market volatility.[5]

MFA supports the adoption of a recalibrated short sale disclosure framework. We recommend a move away from IFPD and instead toward publicly disclosing the aggregate net short positions on an issuer-by-issuer basis utilising the private position reporting information received by regulators. This policy approach of aggregated public disclosure ("APD") would better promote price discovery and market efficiency yet still provide the market with meaningful data transparency. We note that in the United States the SEC is currently finalizing a short selling rule which, as proposed, rejects IFPD in favor of an APD model. In the Appendix to our response to this CfE, we include a bibliography illustrating the strong body of empirical evidence on the shortcomings of IFPD.

Operational Challenges and Short Sale Bans

While addressing public disclosure would have the greatest positive impact on the market and investors, there are two additional areas where the UK's SSR could be improved to enhance the competitiveness of its global market:

- **Addressing operational challenges related to position reporting to the regulator:** MFA fully supports reporting short positions to the regulator. This ensures that authorities have clear oversight of the market and can address any concerns related to issuers or market manipulation. However, operational challenges make this system costly and burdensome. The data and systems for reporting could be improved to deliver greater efficiency to the market. We also urge policymakers to conduct a thorough cost-benefit analysis on the very low regulatory reporting thresholds that are currently in place. Reverting to a 0.2% reporting threshold for position reporting would greatly reduce costs and compliance burdens for UK market participants. We would also urge policymakers to consider increasing the subsequent

atmosphere of the eurozone sovereign debt crisis. We encourage EU policymakers to reconsider these same elements of their regulatory framework.

[4] *See* Copenhagen Economics' white paper: Market Impact of Short Sale Position Disclosure, available at: https://copenhageneconomics.com/wp-content/uploads/2021/12/disclosure-requirement-for-short-positions.pdf.

[5] *Id.*

reporting increments to 0.2% to reduce the number of reports required with associated compliance burden and cost.

- **Providing additional guidance and clarity on the implementation of short sale bans:** Regulatory intervention in the form of short sale bans has historically led to more harm than good for global markets and market participants. We applaud the FCA for the very judicious approach it has taken during periods of market volatility. The FCA has refrained from deploying short selling bans when other regulators decided to enact short sale bans. Notwithstanding the FCA's approach, we would advocate that the regulator provides as much *ex ante* detail and clarity on the requirements and capabilities related to short sale bans to help inform operational planning. A general playbook setting out clearly the rules that would apply in any short sale ban situation would greatly help market participants be fully prepared for these unlikely scenarios. The need for up-front clarity is not theoretical. It has been illustrated by real experiences during short sale bans in overseas jurisdictions.

MFA believes that these policies can act as an important building-block toward the "smarter financial regulatory framework for the UK" that HM Treasury has set out to achieve. These targeted modifications would go a long way toward enhancing the attractiveness and competitiveness of the UK's markets for alternative asset managers and institutional investors. We remain a resource to policymakers throughout this regulatory reform process.

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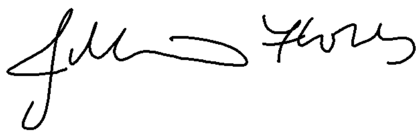
MFA appreciates the opportunity to provide these comments to HM Treasury in response to the Call for Evidence. If you have any questions about these comments, or if we can provide further information, please do not hesitate to contact Andrew Malin, Manager – International Government Affairs, or the undersigned at (202) 730-2600.

Respectfully submitted,



Jillien Flores

Executive Vice President and Managing Director

Global Government Affairs

MFA

Call for Evidence on the Short Selling Regulation Review – Questions and MFA's Response

Box 1.A Questions:

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

Yes, short selling is a critical element of healthy, effective, and confident global financial markets. As stated in MFA's Short Selling White Paper[6], investors use short positions to express a view that a security, such as a stock, is overvalued or to hedge against risk. Short selling has huge benefits to end users. Pension funds, mutual funds and endowments earn returns by lending stocks to short sellers. Market makers are expressly exempt from restrictions on uncovered short selling because they facilitate the buying and selling of stocks, greatly boosting overall liquidity of markets. Short selling is employed widely. It contributes to overall market quality, dampens volatility, and promotes fraud detection and capital formation. There are a number of reasons that short selling is an important public good:

- **Short Selling improves price formation:** The prices of equities are accurate to the extent that they best correspond to the fundamental value of the company issuing shares. That value is determined by the collective opinion of all market participants – the more opinions the better. When an investor engages in fundamental research and determines that a stock is underpriced, they buy it. If it is overpriced, they sell it. But even if an investor does not own the stock, they can express the view that a share is overpriced by way of a short sale, thereby adding information to the market and improving stock price accuracy. In this way, fundamental investors such as hedge funds, some collective investment schemes, and other stakeholders, contribute to price efficiency through the use of short selling.

- **Short Selling Makes Markets More Liquid and Less Volatile for the Benefit of Investors:** Short selling contributes to liquidity and dampens volatility. Short selling allows market makers to better fill customer orders for securities. It helps offset imbalances in the flow of buy and sell orders when the demand to buy a certain stock would otherwise exceed supply. A liquid market also has lower transaction costs, which accrues to the benefit of investors. Evidence shows that during a price decline, short sellers will often sell less, or close out of their short positions by purchasing shares of the security, which offsets sales by long position holders.[7] The experience in several European countries, at the outset of the COVID-19 pandemic in spring 2020, demonstrates that where short selling is restricted the result is greater market volatility.[8]

- **Capital Is More Efficiently Allocated to Companies and Leads to an Increase in Long Investment:** Short selling improves the allocation of capital to its most productive users by

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[6] MFA's Short Selling White Paper, available at: https://www.managedfunds.org/wp-content/uploads/2022/04/Short-Selling-White-Paper.pdf.

[7] *See, e.g.,* Daniel Aromi and Cecilia Caglio, Memorandum from SEC Office of Economic Analysis to SEC Chairman Christopher Cox on Short Selling Activity During the First Weeks of September 2008 (Dec. 16, 2008), ("SEC Memorandum"), available at: http://www.sec.gov/comments/s7-08-09/s70809-369.pdf.

[8] Siciliano, Gianfranco and Marco Ventoruzzo, "Banning Cassandra from the Market? An Empirical Analysis of Short-Selling Bans during the Covid-19 Crisis." European Company and Financial Law Review 17, no. 3-4 (2020) 386-418.

promoting the accuracy of stock prices. If a stock is overvalued, too much capital may be allocated to the company. The result is that overvalued companies may fund less profitable or less sound projects, while profitable projects could go underfunded by companies whose stock is undervalued. The liquidity that flows from short selling likewise enhances capital formation. Investors prefer to invest capital in liquid markets with low transaction costs and one in which they can quickly establish and liquidate positions. Some large alternative asset managers run a 'market neutral strategy', meaning they often take matching long and short positions seeking to profit from both increasing and decreasing prices in one or more markets. A market neutral strategy often seeks to manage broader market volatility in a portfolio or completely avoid a specific form of market risk. Therefore, the ability to take short positions allows for much greater overall long investment. Conversely, restrictions on short selling force managers with a market neutral portfolio to significantly restrain from investing.

- **Short Selling Detects Corporate Fraud:** The collapse of companies such as Enron and Wirecard demonstrate the important role that short sellers play in detecting fraud. Even in the face of intense issuer retaliation – including physical attacks in the case of Wirecard – the careful research of short sellers plays a fundamental role in exposing cases of financial irregularities at issuers.
- **Short Selling Can Be Used as a Tool for Achieving Environmental, Social and Governance Goals:** As explored in MFA's June 2022 White Paper[9], incorporating short selling as part of an ESG-focused investment strategy can help shift capital away from high-emissions companies while simultaneously limiting losses for investors.
- **Reduces the Risk of Market Bubbles:** From a long-term perspective, securities that are overvalued can be problematic for the economy and global markets. The market will eventually correct the mispricing, but in the meantime, real resources may flow to the overvalued stock or industry. The correction can be swift and disruptive. Short selling helps reduce the risk of market bubbles by providing selling pressure and market indications to overvalued companies or sectors.

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

Yes. Short selling is and should continue to be subject to a robust regulatory regime. Regulation is important for ensuring settlement discipline and maintaining the orderliness of public markets. It is also important that regulators are given access to information which allows them to properly surveil the markets and protect investors. Regulation should however avoid deterring short selling in the market.

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

No, the SSR framework puts a disproportionate regulatory burden on short sellers in the UK market.

The burden of individual firm public disclosure ("IFPD") of net short positions is by far the most egregious policy within the SSR framework and particularly burdensome on market participants seeking

[9] The Use of Short Selling to Achieve ESG Goals, available at: https://www.managedfunds.org/industry-research/the-use-of-short-selling-to-achieve-esg-goals/.

to do business within the UK. There is a stark asymmetry between IFPD of long positions – set at 5% of total shares issued under the Transparency Directive – and IFPD under the SSR – set at just 0.5% of total shares issued. This is not only a heavy compliance burden, but also creates market distortions which hurt investors and make the UK market less competitive. These issues will be discussed in further detail below (see MFA responses to Questions 15-19).

In particular, the framework for reporting short positions to the regulator is onerous and adds significant cost to doing business in the UK market. There are areas where we feel that legislation could strike a better balance between the obligations of issuers and investment managers. We would urge HMT and the FCA to address the following operational challenges to reduce regulatory burden on managers all of which are discussed in further detail in response to Questions 10-12:

- **No 'golden source' for Total Shares Issued:** Calculating the denominator (the total issued share capital of the issuer) for short position reporting is cumbersome and costly given that there is no single source of data (so-called 'golden source') available. We suggest alignment with the data that issuers are already obliged to disclose for the purposes of long position reporting under the FCA's Disclosure Guidance and Transparency Rules sourcebook ("DTRs").
- **Low Reporting Threshold:** The move from an already-low threshold of 0.2% of total shares issues to 0.1% to March 2020 has added significantly to the number of firms' daily reports. We urge HMT to consider from a policy perspective whether information received at 0.1% level is still required for monitoring purposes by the regulator and whether cost-benefit analysis of moving from the original 0.2 % threshold can be maintained.
- **Incremental Reporting Thresholds:** Not only must market participants report when triggering a 0.1% threshold, they must also file additional reports with each increase of 0.1%. These additional incremental thresholds add significantly to the cost and compliance burden on firms operating in the UK market. We would urge policymakers to consider setting the incremental thresholds at a higher level.
- **Timing for Calculation and Reporting of Net Short Positions:** Thought should be devoted to the timing of calculation of short reporting (midnight at day position is held – T) and timing of reporting (15:30 on following day – T+1). This narrow timeframe creates a significant compliance burden, especially for firms operating across multiple time zones and is much more onerous than the T+4 standard in place for long position reporting. Furthermore, the midnight timing for calculation of total shares creates difficulties given that issuers may amend this data later in the day.
- **Submission Format:** Short positions must be reported manually through the FCA's Electronic Submission System (ESS). There is no availability to upload data via a machine-readable interface such as XML. The current system is inefficient and creates a significant time-drag for reporting firms. Digital innovation and application in this regard would boost the dynamism of the UK's market. We urge HMT to explore an automated system like those adopted in other jurisdictions, while also maintaining the ability to report manually for firms conducting less frequent reports.
- **UK Exempt List:** Delays to updates of the UK's Exempt List of issuers (i.e. issuers that do not require reporting given primary trading is overseas) and inconsistency with the FCA Portal for short positions reporting add significant compliance burden. We recommend that the FCA publish a positive list of securities that are reportable under the UK SSR. If an issuer's securities are listed on a Regulated Market in the UK and there is no third-country market with greater liquidity than the UK, the issuer's securities and related such securities would appear on the

FCA's 'reportable list.' This would provide a measure of certainty that does not exist within the EU's regulatory framework.

Question 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 SSR framework is part of the foundation for an international dialogue between regulators during periods of economic crisis and market volatility. The information that authorities receive can be valuable in informing international discussions and helping policymakers make collective decisions to address financial instability.

As stated above, short selling provides important benefits to markets, the economy, society, and institutional investors like pension funds. Despite this, short selling is often misunderstood and viewed with distrust by business and media. MFA supports a robust regulatory framework for short selling which helps to build trust and confidence in this important market practice, while not inhibiting or distorting market activity.

Question 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?

MFA does not see the need to rescind or fundamentally reform the SSR framework. Instead, very targeted, but important, modifications in a limited number of areas could bring substantial enhancements and boost the competitiveness of the UK's market.

MFA notes that the SSR was debated and discussed in 2010-2012 during the aftermath of the global financial crisis and in the midst of the eurozone sovereign debt crisis. This was an extremely politically charged atmosphere with high alarm regarding the potential default of both corporate businesses and sovereign states. In some jurisdictions, short sellers were unjustifiably portrayed as responsible for falling prices of the issuers and/or sovereign debt. Data has shown that it was assorted external factors that caused price collapse. Therefore, the current SSR framework agreed by compromise may have always been overly restrictive and not reflective of the UK's healthy and confident financial markets.

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

The SEC is currently finalizing new short selling disclosure rules. There is one aspect of the proposed regime that we feel operates better that the SSR. U.S. policymakers consulted and carefully considered incorporating individual firm public disclosure ("IFPD") of short positions into their framework. However, based on the evidence and experience in other jurisdictions – namely the EU and UK – they opted for aggregated public disclosure ("APD") of net short positions at issuer level without attribution to individual short sellers. The SEC explained, "[We] believe that publicly disclosing the identity of individual reporting Managers may not currently be necessary to advance the policy goal of increasing public transparency into short selling activity, and that aggregating across reporting Managers would help safeguard against the concerns noted above [in this release] related to retaliation against short

sellers, including short squeezes, and the potential chilling effect that such public disclosure may have on short selling."[10]

Box 2.A Questions

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

MFA feels the restriction of uncovered short selling functions well. Uncovered short selling is restricted in most markets and MFA is not advocating for change in this regard. The protocols that have emerged between the buy-side and sell-side under the current regime are well established and we do not see significant problems that need to be addressed through regulatory change.

Question 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?

As stated in Question 7 above, MFA feels the established protocols function well and regulatory change to uncovered short selling restrictions is unnecessary at this time.

Question 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?

MFA members have not had experienced issues with settlement discipline relating to short selling activity.

Box 2.B Questions

Question 10: Should the FCA specifically monitor short selling?

Yes, the FCA should specifically monitor short selling in the market. As stated above, short selling is an important tool for achieving price discovery and, in extreme cases, detecting issues with corporate governance and corporate fraud. Given the careful research that some alternative asset managers dedicate to understanding why certain companies may be over-valued, they often identify issues before regulators. Therefore, short selling data should be monitored closely by authorities to detect and address issues of corporate misconduct early for the benefit of shareholders, the economy, and society.

This said, there is tremendous cost and burden to market participants associated with daily reporting at the very low threshold of 0.1% and then again at further increments of 0.1%. MFA respectfully requests that statutory regulation requires policymakers to carry out an analysis of the current reporting thresholds to assess if these benefits outweigh the heavy costs amassed by firms operating in the UK's financial market due to daily reporting thresholds and the drag this may have on the global competitiveness of the UK market. This analysis could consider alternative reporting thresholds or models which do not pose disproportionate costs.

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

Yes, for the reasons set out in Question 10 as well as in Question 4, the FCA's monitoring of short selling supports the integrity of the market and fosters confidence.

[10] SEC, Short Position and Short Activity Reporting by Institutional Investment Managers, 87 Fed. Reg. 14950, 14955 (Mar. 16, 2022).

Questions 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?

Daily reporting of net short positions to the FCA is very costly and demands significant compliance burden to market participants. While the UK's system is more efficient than some EU jurisdictions with similar SSR reporting standards, it lags behind others. Some firms employ numerous employees simply to carry out short position reporting. The costs accrued for the headcount needed, as well as the significant IT outlay involved, are considerable.

We highlight a number of areas where reporting of net short positions could be modernised and automated. Addressing the following operational challenges would greatly enhance efficiency and boost the attractiveness of the UK's financial market:

1. **'Golden Source' of Data for Total Shares Outstanding and Timeframe for Position Reporting**

We urge policymakers to create one 'golden source' of data for 'total shares outstanding' (*i.e.,* the denominator for SSR position calculation).

There are key differences in the UK between long reporting regimes, as set out in the FCA's Disclosure Guidance and Transparency Rules sourcebook ("DTRs"), and short reporting as set out in the SSR. A key difference between the two regimes is that the DTRs impose an obligation on the issuer to provide the correct information needed (under DTR5.6.1[11]) in order for market participants to meet the reporting obligations (under DTR 5.1[12]). However, there is no similar obligation under the SSR for the issuer to provide 'golden source' data in order for market participants to meet their SSR reporting obligations.

We suggest that the FCA include denominators for SSR-reportable issuers in a machine-readable reference data repository, while also maintaining the FCA's NSP portal or a similar human-readable interface, similar to the practices of the Netherlands and Sweden.

Denominator information should be provided by either the issuers themselves or the exchanges on which the issuer's equity instruments are listed. Providing denominators in a machine-readable format would allow market participants to determine whether NSP notification obligations arise with certainty and allow firms to build technologies to make such determinations. Such technology investments will pay large dividends by removing minutes to hours of time that are spent by market participants looking up and confirming the accuracy of denominators. It would also, of course, reduce human error attendant in the process.

Of course, firms with fewer positions to monitor in the UK should also have a reliable way to look up denominator information, such as a web-based user interface.

Alternatively, all of the necessary information for market participants to calculate the Total Shares Outstanding for the SSR should be provided in issuer regulatory news services (RNS) notifications.

As a final alternative, policymakers could allow market participants to rely on the information provided via the DTRs as reliable reference data for SSR position reporting (i.e. maintain the same 'golden source' across both regimes).

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[11] Disclosures by Issuers, available at: https://www.handbook.fca.org.uk/handbook/DTR/5/6.html.

[12] Notification of the acquisition or disposal of major shareholdings, available at: https://www.handbook.fca.org.uk/handbook/DTR/5/1.html.

MFA recognizes that the DTR and SSR denominator requirements differ in that DTR excludes treasury shares from the calculation while SSR includes both treasury and non-voting shares[13]. We would note that this approach contrasts with many EU countries in that treasury shares (if relevant to that country's regime) are included in the denominator for both long and short positions. To that end, the data provided by the issuers to the respective exchanges under the Transparency Directive ("TD") obligation can be relied on for both long and short position reporting.

In addition to the difference in denominators between the DTRs and SSR position reporting, the DTR obligation requires updated information on total shares outstanding to be provided no later than the end of the day after the change is made.

SSR position calculations are generally calculated at midnight on the day the position is held (T) and then reported no later than 15:30 the next day (T+1) so any updates/changes required under DTRs which have until end of the day on T+1 may be too late for the reporting deadline under the SSR.[14]

MFA would also note that reporting for long positions under DTRs is required on a T+4 basis, which is much later than the deadline for SSR position filings.

There are a number of practical and operational implications that follow from the lack of a golden source of data:

- It is difficult for firms to get 'total shares outstanding' from one reliable source often requiring multiple vendor data feeds/manual cross checks. For example, one of the key data vendors which is used widely across the market to comply with the SSR (both for UK and EU purposes) receives the shares outstanding from exchanges and publishes the data provided by the exchange. However, the UK exchanges do not provide shares in issue including treasury shares, so an additional data source is required to check the treasury shares manually, but only for the UK (Ireland and Malta), and only specifically for the SSR.
- Many UK-listed issuers provide information to the exchange on updates to their shares in issue the morning following the change, usually at around 7am via regulatory new services ("RNS"). As a result, firms might unknowingly file notifications with stale information or may build costly and

[13] The UK has a different denominator requirement between the two reporting regimes - in the UK under the DTR rules the denominator <u>excludes</u> treasury shares from the calculation (*e.g.,* DTR 5.8.8. states: "The number of voting rights to be considered when calculating whether a threshold is reached, exceeded or fallen below is the number of voting rights in existence according to the issuer's most recent disclosure made in accordance with DTR 5.6.1 R and DTR 5.6.1A R3 but disregarding voting rights attached to any treasury shares held by the issuer (in accordance with the issuer's most recent disclosure of such holdings"). In contrast, under the SSR, Delegated Regulation (EU) 918/2012 (as retained under UK law) states: "For the issued share capital, when issuers have several share classes, the total number of shares issued in each class and shall be taken into account and added up," and thus it is necessary to <u>include</u> both treasury shares and non-voting shares in the denominator when calculating short positions.

[14] In practice, there are additional issues firms face when relying on the disclosures called for by DTR 5.6.1. First, UK issuers may update 'total shares outstanding' in between the disclosures required by DTR 5.6.1A and B if such updates are "immaterial," with the result being that firms need to monitor other sorts of regulatory disclosures (for instance, Person Discharging Managerial Responsibilities ("PMDR") notifications or Rule 2.9 Takeover notices may contain 'total shares outstanding' figures). And as described above, DTR 5.6.1 disclosures only apply to classes of shares to which voting rights attach. Because non-voting shares classes may not be disclosed in DTR 5.6.1. disclosures, firms occasionally need to add figures from a DTR 5.6.1 disclosure to share figures contained in other disclosures (which may be outdated with respect to voting share classes).

time-sensitive processes to manually check the announcements on exchanges' websites to identify if there are any changes to shares in issue that need to be taken into account for calculation of the position that morning.

- This has to be a manual process as there is insufficient time for the issuer updates to be made to reference data systems and disseminated to market participants. This removes the ability to fully systematically generate net short position (NSP) notifications under the SSR.

We also note that some EU jurisdictions (e.g. Sweden and the Netherlands) dictate the denominator used in their Portal which eliminates compliance burden on market participants.

To greatly enhance the efficiency of the UK's market, MFA urges policymakers to consider the following solutions:

- Provide a machine-readable, golden source of data for 'total shares outstanding' allowing firms to adopt technology-driven approaches to reporting to reduce cost and regulatory burden.
- Consider aligning both the DTR and SSR reporting requirement in the UK to use the same denominator and either (i) amend the DTRs to require that issuers provide the data in a timeframe that will enable accurate reporting under the SSR or (ii) extend the reporting deadline in the SSR to account for delays in the issuers releasing their changes in capital and voting rights, or
- Amend the SSR requirement to use the information that was published at midnight on the day of the position, removing the risk of misreporting due to later updates provided by issuers under DTR obligation.
- Amending the regime more fundamentally to remove the need to calculate the position as a percentage of shares in issue on a daily basis.
- Providing FAQs/Guidance that incorrect filings due to inaccurate reference data provided by a large market provider would not result in a regulatory sanction, as long as it can be demonstrated that such a source is used, in other words remove the need to obtain the very latest information published at 7am in the morning to calculate the position and identify disclosure obligations that day.

2. Scope of obligations (UK FIRDS)

There are a large number of instruments / issuers on UK FCA Financial Instruments Reference Data System's (FCA FIRDS) that are primarily traded outside the UK that have not been added to the UK list of exempted shares (UK Exempt List). The written guidance provided by the FCA is that a position is reportable if it is on UK FIRDS with a Relevant Competent Authority (RCA) of UK and it is not on the list of exempted shares. A separate email from the Position Monitoring Unit (PMU) has stated that they are not expecting disclosures from issuers whose primary trading venue is outside the UK, using the same basis as the EU. There is a gap between the official FCA written guidance and communications from the PMU and it would be good if the written guidance could be updated in order to provide certainty for the market participants.

3. Scope of Obligations and Instruments in Scope – UK Exempt List

There are significant delays in issuers being added to the UK Exempt List, even if they are exempted via the FCA portal.

When an issuer is exempted from the FCA Portal, it is no longer possible to submit NSPs; however, many firms' reference data systems ingest and rely on the UK Exempt List to exclude issuers from alert generation.

With the delay in adding issuers to the UK Exempt List there will be alerts that are generated systematically by firms which cause them to go through the process of filling out the forms for notifying the NSPs but that then cannot be notified as it is not possible to submit NSPs.

In addition, the UK Exempt List is not available via an electronic form and has to be downloaded as a spreadsheet.

Delays in updating UK Exempt List and resultant inconsistency with the FCA Portal wastes firms' resources in making or reviewing NSPs for issuers out of scope of reporting requirements.

With a view to addressing inefficiencies, we suggest removing the UK Exempt List altogether. If the primary trading venue for the instrument is not in the UK, we suggest not setting the FCA FIRDS Relevant Competent Authority (FIRDS RCA) to UK. If this field is used for other purposes, we suggest creating a new field in FCA FIRDS for UK Short Reporting RCA and amending that to UK or ex-UK and setting all instruments that are primarily traded outside the UK to ex-UK.

Alternatively, we suggest that authorities should be able to ensure that the UK Exempt List is updated in a timely manner to close the gap between the list and the FCA portal and reduce the unnecessary and manual burden on market participants making or reviewing NSPs for issuers out of scope of reporting requirements.

4. Operational Challenges with Submission Process

Manual entry of NSPs

The FCA portal for manual entry of NSPs is highly inefficient from a data input perspective. The manual nature of this means that it takes on average 2 – 4 minutes to enter a single NSP (with on average at least 14 mouse clicks). With the lower 0.1% private NSP notification threshold being retained this has increased the number of filings that are made considerably. If a firm makes on average around 30 NSP notifications per day this can take approximately 2 hours to complete filings for the FCA, including validation processes. UK submissions are still one at a time, taking several minutes to complete for each individual filing.

We note that some EU jurisdictions (e.g., Germany) allow bulk upload of short position notifications in XML format, Furthermore, other regulatory notifications and filings in overseas jurisdictions, as well as in the UK for other regulatory purposes, are capable of being, or are required to be, filed in an electronic format. Allowing firms to upload one or more electronic filings means not only that firms do not need to devote minutes to hours of time preparing NSP notifications, but it also allows for less error-prone submissions. Those firms that file large numbers of NSP notifications per day will be able to make an initial investment in technology that would allow full automation of the NSP file generation and upload process. If this were to be combined with golden-source recommendations made above, it would be possible for firms to fully automate the NSP calculation and filing process.

We would recommend that the FCA also maintain the option of reporting via its existing NSP portal (or similar system) to allow additional flexibility for those market participants who may only report on an infrequent basis.

Registration of new reporting entities, or new individuals to submit reports

The registration process for new reporting entities or setting up new staff to make reports is inefficient, with a request needing to be raised at each individual and entity level, without the ability for an individual to submit a request for a number of entities at the same time.

To modernise position reporting, MFA suggests policymakers consider allowing submitters to provide a file of all positions, with the five data points required through an automated process. For example, the long portal allows a spreadsheet upload of chain of control; extending this functionality to the short portal for the submission of NSPs would be a significant step forward. A good example is point-to-point file transfers, via Simple Object Access Protocol (SOAP). This system which has been adopted by Germany's BaFin is a useful platform for sending files directly without human intervention. Alternative machine-readable formats such as an XML or spreadsheet upload would also be beneficial.

Question 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?

We recognise that the FCA sees value in the additional data it receives with the lower 0.1% reporting threshold. However, we urge policymakers to consider that the 0.2% daily threshold is already very low and requires a significant heavy lift for compliance teams. The lower threshold of 0.1% has added considerably to this burden with substantial costs on firms operating in the UK. This measure was introduced in March 2020 as a crisis mitigation measure. It has never been raised despite the resilience and calm of financial markets since the spring of 2020.

Not only must market participants report when triggering a 0.1% threshold, they must also file additional reports with each increase of 0.1%. We also note that these additional incremental thresholds add significantly to the cost and compliance burden on firms operating in the UK market. We would urge policymakers to consider setting the incremental thresholds at a higher level (e.g. 0.2%).

MFA queries the usefulness of this additional information to the regulator. We request that statutory regulation requires policymakers to carry out an analysis of the current reporting thresholds to assess if these benefits outweigh the heavy costs invested by firms operating in the UK's financial market and the impact this may have on the global competitiveness of the UK market. This analysis could consider alternative reporting thresholds or models which do not pose disproportionate cost on UK industry.

We would also note that changes and deviations from standard thresholds, like the change from 0.2% to 0.1%, multiply the costs and burdens of regulatory reporting by firms. An ideal situation from a market competitiveness perspective would be to adopt a higher reporting threshold that is adhered to and not lowered at times of market volatility.

Finally, we urge policymakers to consider the significant asymmetry between the extremely low threshold for short reporting and the much higher threshold legislated for reporting of long exposure to companies set at 5% under the Transparency Directive.

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

MFA has provided a comprehensive response to Question 12 of the CfE.

Box 2.C Questions

Question 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?

No. MFA does not support the requirement for individual firm publicly disclosure ("IFPD") of net short positions under the SSR. MFA feels removal of this requirement would be one of the most important policy changes that policymakers could incorporate with the greatest benefit to investors and to the overall dynamism of the UK's capital markets.

The experience of the past years since the SSR was implemented points toward very positive outcomes should the IFPD requirement be removed. Market participants would be more engaged in trading activity in UK markets enhancing market liquidity. Firms would be more willing to accurately express economic views through their positions which would enhance price discovery and detect corporate malfeasance. Finally, removing this *de facto* barrier on short activity would unlock the ability for investors to deepen their investments in operations in the UK.

We do believe that certain categories of short position data, if collected and reported appropriately, will promote greater risk management among market participants and may facilitate capital formation. We further believe that transparency of certain anonymized and aggregated short position data is beneficial to markets and market participants and are supportive of equal access to this information by all investors. However, providing for IFPD of short sales/short positions has direct and serious negative consequences for the depth, liquidity, and quality of financial markets. In particular, as explained further below, this model of public reporting has the following negative consequences:

- Impaired ability of investors to pursue fundamentally-driven actively-managed investment strategies (with material knock-on impacts to the efficiency of passive/index-based investing);
- An increase in imitative behavior (uninformed copy-cat type investing) and herd behaviour;
- A decrease in the economic incentives for individuals to engage in the fundamental research necessary to root out poor corporate governance, potential fraud (*e.g.*, increasing the risk of Wirecard-type events), or simply to express that a company's stock is overvalued;
- An increase in the potential for manipulative activities (e.g., short squeezes and issuer retaliation); and
- Diminished market quality from less efficient price discovery, inefficient capital allocation, lower trading volumes, higher market volatility, higher transaction costs (wider bid/offer spreads), and lower market efficiency.

Question 16: How do you use public net short position disclosures and how does it support your firm's activity or the market?

Meaningful transparency flows from investor scrutiny of public companies to best ensure that stock prices accurately reflect their fundamental value. This transparency is only possible when investors are incentivized to do fundamental research and ask hard questions. Certain types of public disclosure can

promote accountability and efficiency and provide investors with understanding of broader trading activity in the market. However, as noted above, public disclosure of short positions must be appropriately calibrated to provide market participants with meaningful information without deterring short sale activity. Promoting aggregated public disclosure ("APD") of the total net short interest at issuer level provides meaningful information for the market.

Question 17: Do the public disclosure requirements contribute to or create any unnecessary barriers to short selling? If yes, please provide details.

While we support aggregated public disclosure ("APD") of total net short positions of issuers, we believe that individual firm public disclosure ("IFPD") of short interests has a number of negative effects on the market and provides regulators no additional material information. Of greatest concern is that it facilitates copycat and order anticipation strategies that discourage liquidity supply, fundamental analysis vital to price efficiency, and hedging that facilitates capital formation.

The following are descriptions of some the negative effects of IFPD:

IFPD causes market-distorting behavior

Mandated IFPD requires investors to disclose their active investment strategy, which risks disclosing investors' proprietary trading strategies, compromises their ability to manage their market risk exposure, leads to retaliation, or, as the UK/EU experience has shown, results in an investor deciding not to fully express their view. ESMA reviewed the data collected pursuant to the SSR that requires IFPD at the 0.5%. ESMA's own analysis found that the public reporting thresholds appeared to reduce price discovery and encourage market distorting herding behavior.[15] ESMA also found that when an individual firm's short position is disclosed publicly, there is a significant increase in the likelihood that other investors will likewise exceed the public disclosure threshold.[16] In either case, the distortion caused by the IFPD threshold led demonstrably to less informed stock valuation.

IFPD could subject all investors and companies to higher risks and costs

The effort to develop an informed decision to take a short position is substantial, and unlike purchasing a stock, the trade itself is costly to execute. Short sellers pay fees to borrow stock, they are generally required to collateralize the stock loan, and they are potentially exposed to unlimited losses. Mandated IFPD effectively causes short sellers to disclose their active investment strategy, which undermines the value of their fundamental research or, as the UK/EU experience has shown, results in an investor deciding not to fully express their views (and not getting the full benefit of their views if correct).

To the extent that IFPDs have the effect of making such trades less economic, there are fewer short sales, which harms market quality.[17] More importantly, managers may trade their active investment strategies, which help soften market distorting behavior, for passive investment strategies, which would reduce market efficiency.[18]

[15] See ESMA Report on Trends, Risks and Vulnerabilities, N. 1, 2028 (available here).

[16] See ESMA Report on Trends, Risks and Vulnerabilities, N. 1, 2028 (available here).

[17] *See* Jank, S., Roling, Christoph, and Smajlbegovic E., "Discussion Paper: Flying under the radar: the effect of short-sale disclosure rules on investor behavior and stock prices" (2016).

[18] *See* Wermers, Russ. 2019. "Active Investing and the Efficiency of Security Markets." SSRN Electronic Journal.

Furthermore, many mangers operate market neutral strategies which match short and long investments. Constraints on short selling in the form of IFPD therefore place significant limitation on overall investment for these market participants.

IFPD increases the risk of short squeezes

Proponents argue that increased IFPD of short sales could reduce abusive trading, but such public disclosure also facilitates abusive trading. IFPD of short positions subjects market participants to the risk of a short squeeze, that is, when the price of a security is pushed upward or the availability of stock to borrow is restricted with the intent of forcing short sellers out of their positions. As the price of a shorted stock rises sharply, short sellers must add cash to their margin accounts or close out their short positions at the increased stock price. Investors with short positions that are publicly disclosed are more vulnerable to a short squeeze. The GameStop squeeze, for example, occurred because a short, via a listed put option, was made public in an SEC filing. Short sellers are not the only negatively impacted parties in a short squeeze; many retail investors with long positions were greatly harmed by the price runup and then retraction of GameStop[19]. This short squeeze was not based on any fundamental view of the value of GameStop which has seen flat revenues and declining earnings per share in the time that has elapsed since the short squeeze of January 2021.

IFPD facilitates issuer retaliation

Issuer retaliation against short sellers can be manifested in short squeezes, harassment, intimidation, false claims of price manipulation, threats of violence, and physical attacks. At these inflection points, short sellers face hostility and are often wrongfully blamed in times of crisis or major price declines in the market. If management knows who the individual short sellers are, they know who to retaliate against. In an interview with ProMarket, Fahmi Quadir, short seller, founder and CIO of Safkhet Capital, observed that short sellers already run the risk of lawsuits, harassment, and even “mortal threats.” In her view, “most fundamental short sellers have already been wiped out” due in large part to the risk of retaliation.[20] Quadir herself was the victim of a physical attack outside her apartment in New York during the time she was researching corporate fraud at Wirecard.[21] Most recently, short sellers were targeted during the GameStop squeeze. In his written testimony for the U.S. House Financial Services Committee February hearing on the GameStop short squeeze, Gabriel Plotkin, Founder and Chief Investment Officer for Melvin Capital Management, testified that he had been subject to antisemitic slurs by Reddit platform users as a result of his firm’s short positions.[22]

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[19] See Harwell, Drew. 2021. “As GameStop stock crumbles, newbie traders reckon with heavy losses.” (available here).

[20] *See* Kasperkevic, Jana, “Fahmi Quadir: Short Sellers are Always an Eager Boogeyman,” ProMarket, February 22, 2021.

[21] *See* McCrum, Dan, “Money Men: A Hot Startup, A Billion Dollar Fraud, A Fight for the Truth”, June 16, 2022.

[22] *See* Forbes, “GameStop Short Seller Says Reddit Trolls Targeted Him With Anti-Semitic Harassment” (Feb 19, 2021); Gabriel Plotkin, Founder and Chief Investment Officer for Melvin Capital Management testimony for House Financial Services Committee February 18, 2021 hearing, “Game Stopped? Who Wins and Loses When Short Sellers, Social Media, and Retail Investors Collide” (available here).

IFPD cuts off the free flow of information and complicates issuer engagement

IFPD of short positions leads to issuers refusing to meet or excluding short sellers from discussions in which issuers discuss their public disclosures with investors. Many have recognized the importance of shareholder engagement. Any chilling of the free flow of information between investors and issuers can hamper the benefits provided to the market by well-informed short sellers. Some investment firms conduct thousands of meetings with companies each year for the purposes of research. The effectiveness and fairness of this research and issuer engagement can be impaired by IFPD of short positions. It is not uncommon for some investment firms to hold differing internal views on the same issuer. IFPD of short positions can therefore misinform issuers on the more holistic outlook that an investment firm takes. Thus, IFPD misinforms issuers of how some investment firms operate. This in turn can alter issuer behaviour hindering the free flow of information in company meetings. This deters the ability of managers to conduct effective company research to the detriment of institutional investors and other end-users.

Institutional investors may avoid alternative investment classes

Many institutional investors—such as pension funds, endowments, and foundations—invest in investment vehicles that engage in short selling as a means to mitigate overall risk to their portfolios. During periods of adverse market conditions and market downturns, short selling can be an enormously valuable tool for managing risk and finding reliable returns for institutional investors. Likewise, institutional investors are sensitive to reputational risk and incremental cost increases. IFPD of short positions can lead institutional clients to disfavor investment vehicles engaged in short selling to avoid adverse publicity. As a result, institutional investors may lose the risk management benefits of short sales in the long run, which could ultimately erode returns to these investors.

Question 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?

We do not support the publication of short sale position data at the individual manager level, rather than aggregated across all reporting managers prior to publication, even if the reporting manager's identifying information, including its name and active LEI, is removed in an effort to anonymize the information published. The potential risks and harms described above are still present in this approach because despite measures designed to help anonymize published information, it may still be possible for market participants to identify certain reporting managers and retaliation could result in a reduction in short selling, along with a reduction in the corresponding liquidity and price transparency benefits. Furthermore, publishing manager-level data—even if anonymized—dissuades institutional investment managers from pursuing short strategies to avoid having to report manager level short position data into a database with significant amounts of sensitive manager-level position information. This approach could continue to cause real and material harm to stock price efficiency, market liquidity, and competition in global markets.

Question 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?

For the reasons stated above, we support aggregated public disclosure ("APD") of short sale positions by issuer. We think this should replace, rather than supplement, IFPD. In contrast to IFPD, APD of short interest would provide investors with decision-useful information on the market sentiment of a particular security.

Box 2.D Questions

Question 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?

MFA supports policies that underpin and enhance greater market liquidity. We support the current exemptions for market making activities and primary market operations which enhance liquidity and lower transaction costs. We support a formalisation of the current FCA approach of a broad interpretation of the market making exemption, thereby allowing OTC instruments to be viewed as part of the same activity as on-exchange trading.

Box 2.E Questions

Questions 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?

There is a compelling body of evidence illustrating the risks and inefficiencies associated with short selling bans and restrictions. As set out in MFA's Short Selling White Paper:

- A 2004 study demonstrated shorting constraints allow stocks to become overpriced. When firms take anti-shorting positions, their stock returns are significantly low for a while thereafter. In extreme cases, when short sellers look to take a short position but cannot, overpricing can be particularly prevalent.[23]
- Studies conducted in the years since the global financial crisis demonstrate that short selling bans damage the price discovery process by increasing information delay, that is, it takes longer for the market to reach consensus on the accurate price of a given stock.[24] A 2012 study of the United Kingdom's 2008 ban on short sales found that the ban impaired price discovery. Unsurprisingly, lifting bans improves price discovery.[25] A 2014 study of China's 2010 pilot to lift a ban on short selling and margin-trading on a designated list found lifting such bans increased price efficiency.[26]
- In response to COVID-19 related market downturns, Austria, Belgium, France, Greece, Italy, and Spain imposed temporary short selling restrictions. Studies that have analyzed the effects of these bans found that banned stocks had lower liquidity, higher volatility, higher transaction

[23] Lamont, Owen A., Go Down Fighting: Short Sellers vs. Firms (July 2004). NBER Working Paper No. w10659, Available at SSRN: https://ssrn.com/abstract=579806

[24] Baki Cem Sahin, Fatih Kuz, The effects of short selling on price discovery: A study for Borsa Istanbul, Borsa Istanbul Review, 2020.

[25] Ian W. Marsh, Richard Payne, Banning short sales and market quality: The UK's experience, Journal of Baking & Finance, Volume 36, Issue 7, 2012, Pages 1975-1986.

[26] Eric C. Chang, Yan Luo, Jinjuan Ren, Short-selling, margin-trading, and price efficiency: Evidence from the Chinese market, Journal of Banking & Finance, Volume 48, 2014, Pages 411-424.

costs, and abnormal returns when compared to non-banned stocks.[27] Separate studies show that stocks, on which short selling bans are imposed, ultimately had an increased likelihood of default.[28] Short selling boosts market liquidity and lowers transaction costs for all investors; when it is restricted, market makers charge buyers more and sellers receive less for those stocks covered by the short sale ban.

- Similar results were observed during the 2008 financial crisis. In response to claims that short selling was responsible for significant declines in financial companies' share prices, the SEC adopted a temporary ban on short sales of a list of such companies. The result was a less efficient market. Bid-ask spreads increased 3.43 times for U.S. stocks that were subject to the ban, which means that buyers paid more and sellers received less. Notwithstanding the ban, shares of these companies continued to decline and did not appear to be supported by the ban.[29]

With that said, we recognize that the FCA has been very judicious and responsible in its use of market intervention powers. Since the SSR came into force in 2012, the FCA has never banned short selling, even in periods of market stress. Even in the period of extreme market volatility at the outset of the COVID-19 pandemic when six EU jurisdictions implemented bans, the FCA not only opted not to ban, but issued a statement saying there was "no evidence that short selling [had] been the driver of recent market falls" and, "[a]ggregate net short selling activity reported to FCA is low as a percentage of total market activity and has decreased in recent days" and that "[s]hort selling is a critical underpinning of liquidity provision ... The loss of these benefits would need to be carefully balanced before determining that any intervention to prevent short selling was appropriate."[30]

As UK policymakers clearly see this power as a tool only to be considered in the direst market conditions, MFA does not go so far as to advocate that the FCA's powers should be removed. However, we do call for the adoption of very clearly defined regulation and parameters on ban requirements and capabilities. Firms have faced severe operational challenges in other jurisdictions that have implemented short sale bans which could help inform the UK's thinking as it builds additional safeguards around market intervention powers. Challenges have resulted from:

- The inclusion of indices/ETFs in short sale bans. Here we strongly stress the importance of clarity and consistency of exemptions from bans such as excluding activities like market making but

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[27] Siciliano, Gianfranco and Marco Ventoruzzo. "Banning Cassandra from the Market? An Empirical Analysis of Short-Selling Bans during the Covid-19 Crisis." European Company and Financial Law Review 17, no. 3-4 (2020) 386-418.

[28] *See* Whitmore, Travis, "The Effectiveness of Short-Selling Bans," Securities Financial Research, State Street Associates, 2020.

[29] *See, e.g.*, Robert Battalio, Hamid Mehran, and Paul Schultz, Market Declines: What Is Accomplished by Banning Short-Selling?, Federal Reserve Bank of New York, Current Issues in Economics and Finance, vol. 18, no. 5 (2012) ("The preponderance of evidence suggests that the bans did little to slow the decline in the prices of financial stocks.") ("Federal Reserve Short Selling Paper"), available at: https://www.newyorkfed.org/medialibrary/media/research/current_issues/ci18-5.pdf.

[30] See FCA statement: https://www.fca.org.uk/news/statements/statement-uk-markets

especially financial instruments (e.g. baskets, indices, and ETFs). The ability to short indices is essential for hedging purposes;

- Complexity and IT burden associated with the application of bans on a 'look through' basis to ensure compliance (e.g. derivatives positions); and
- The application of short selling bans to hedging activity (as indicated at CfE 2.22).
- Timing challenges – market participants need sufficient time to put a ban in place. Implementing short selling bans go far beyond just turning on a systematic restriction. Practicalities and scope of the ban must be digested and communicated to relevant personnel globally, system restrictions on more complex areas of the ban scope must be tested, and client ready communication prepared for potential questions on the ban and how it impacts their account. This is a labour-intensive effort involving significant collaboration across departments and taking place at time of high market volatility.

Considering the above, we recommend against the use of short selling bans. Should such intervention power remain in the UK regime, we are of the view that it should be amended. To this end, any such short selling ban should only extend to increases of or the creation of new net short positions. The amended regime should also exempt from any short selling bans instruments such as indices, baskets, and ETFs. Finally, application of any short selling ban should be subject to a greater uniformity of approach between relevant national competent authorities to avoid the creation of chaotic market conditions.

All of these operational challenges discussed above point to the strong need for very clearly defined regulatory parameters for the implementation and compliance of short sale bans. We strongly suggest that this clarity be provided and communicated ex-ante so firms have the ability to plan accordingly and be prepared for times of significant market stress.

We suggest that the regulator provides market participants with a clear template or general playbook that they can rely on to provide the clarity they need when a ban is implemented. This template or playbook should address specific questions on how a ban should apply (e.g. list of instruments or percentage of index subject to ban). This ex-ante clarity would ensure, in the hopefully unlikely scenario that UK authorities feel the need to exact a ban, that firms can operationalise this as quickly and seamlessly as possible.

Question 22: Do you think any changes could be made to increase the effectiveness of existing short selling bans?

Please see our input to Questions 21 above.

Question 23: Are there any alternative arrangements to short selling bans that could be put in place (including arrangements from other jurisdictions)?

As noted in question 21, we applaud the FCA and UK authorities for treating its market intervention powers with the utmost prudence and responsibility. We submit that the experience of short selling bans in the UK – with the additional safeguards and clarifications that we suggest above – presents a model which other jurisdictions may wish to emulate as they consider regulatory reform and supervision in the future.

Box 2.F Questions

Question *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?*

We would refer to our response to Question 12 above.

In addition, MFA stresses the need for reliable and clear data regarding arrangements for overseas shares.

In addition, it is important to note that it is not uncommon for liquidity to move from venue to venue across jurisdictions. This has created operational challenges for firms albeit more in the EU context where the 'third country' shares list exempt from reporting is updated very infrequently (i.e. every 24 months).

Box 2.G Questions

Question 25: Please provide any further views on the SSR, including views on the arrangements relating to sovereign debt and sovereign credit default swaps.

We note that the current Review does not consider the short selling regime for UK sovereign debt and UK sovereign credit default swaps. Given the government plans to consider these issues at a later stage, we will plan to engage at that time.

As far as other views are concerned, MFA supports the inclusion of subscription rights in the calculation of the NSP. Additionally, we recommend applying the same approach to convertible bonds on the basis that they embed a subscription right to the share and their exclusion leads to misleading disclosures by firms of short positions in an equity where they hold an offsetting long position in the related convertible bond. If an investor has an economically offsetting long position in a convertible bond to a short position in the related equity security, then by excluding the convertible bond position in the NSP calculation, any resulting short disclosure could be potentially misleading to the market and issuers alike when a firm is risk flat.

Question 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).

MFA's membership operates globally. We do not expect potential changes to the UK's short selling regulatory framework to have any significant operational impacts or impediments. For some global firms, technology investment has already been made for the UK SSR to accommodate Brexit. If reforms aim to streamline and improve reporting regimes, this will reduce operational challenges and costs to firms in the long term. We hope that regulatory reform aimed at fostering a more competitive and dynamic regime for short selling may lead to greater thought across other jurisdictions in this important area. As stated at the outset of our response, short selling provides substantial benefits to pension funds and other institutional investors; to the economy and to society. We urge other jurisdictions to consider exploring regulatory reform that upholds and enhances the critical role of short selling in capital markets.

<u>**Appendix – Literature review on short sale disclosure**</u>

Battalio, Robert, Mehran, and Schultz. Market Declines: What Is Accomplished by Banning Short-Selling (2012). Federal Reserve Bank of New York. Available at: https://www.newyorkfed.org/medialibrary/media/research/current_issues/ci18-5.pdf.

In 2008, U.S. regulators banned the short-selling of financial stocks, fearing that the practice was helping to drive the steep drop in stock prices during the crisis. However, a new look at the effects of such restrictions challenges the notion that short sales exacerbate market downturns in this way. The 2008 ban on short sales failed to slow the decline in the price of financial stocks; in fact, prices fell markedly over the two weeks in which the ban was in effect and stabilized once it was lifted. Similarly, following the downgrade of the U.S. sovereign credit rating in 2011—another notable period of market stress—stocks subject to short-selling restrictions performed worse than stocks free of such restraints.

Bernal, Oscar and Herinckx, Astrid and Szafarz, Ariane, Which Short-Selling Regulation is the Least Damaging to Market Efficiency? Evidence from Europe (January 2014). International Review of Law and Economics, Vol. 37, 244-256, 2014, Available at SSRN: https://ssrn.com/abstract=2387612

Exploiting cross-sectional and time-series variations in European regulations during the July 2008 – June 2009 period, the authors show that: 1) Prohibition on covered short selling raises bid-ask spread and reduces trading volume, 2) Prohibition on naked short selling raises both volatility and bid-ask spread, 3) Disclosure requirements raise volatility and reduce trading volume, and 4) No regulation is effective against price decline. Overall, all short-sale regulations harm market efficiency. However, naked short-selling prohibition is the only regulation that leaves volumes unchanged while addressing the failure to deliver. Therefore, the paper argues that this is the least damaging to market efficiency.

Boehmer, Ekkehart, and Wu, Julie. Short Selling and the Price Discovery Process (2012). Review of Financial Studies. 26, (2), 287-322. Research Collection Lee Kong Chian School Of Business. Available at: https://ink.library.smu.edu.sg/cgi/viewcontent.cgi?article=5687&context=lkcsb_research.

This research shows that stock prices are more accurate when short sellers are more active. First, in a large panel of NYSE-listed stocks, intraday informational efficiency of prices improves with greater shorting flow. Second, at monthly and annual horizons, more shorting flow accelerates the incorporation of public information into prices. Third, greater shorting flow reduces post-earnings announcement drift for negative earnings surprises. Fourth, short sellers change their trading around extreme return events in a way that aids price discovery and reduces divergence from fundamental values. These results are robust to various econometric specifications and their magnitude is economically meaningful.

Bris, Arturo, Goetzmann, and Zhu. Efficiency and the Bear: Short Sales and Markets Around the World (2007). Available at: https://onlinelibrary.wiley.com/doi/abs/10.1111/j.1540-6261.2007.01230.x.

This paper analyzes cross-sectional and time-series information from 46 equity markets around the world to consider whether short sales restrictions affect the efficiency of the market and the distributional characteristics of returns to individual stocks and market indices. The research finds some evidence that prices incorporate negative information faster in countries where short sales are allowed and practiced. A common conjecture by regulators is that short sales restrictions can reduce the relative

severity of a market panic. The authors find strong evidence that in markets where short selling is either prohibited or not practiced, market returns display significantly less negative skewness.

Deng, Sheran, Does Disclosure Deter Short Selling with Noisy Information (October 27, 2020). Available at SSRN: https://ssrn.com/abstract=3720206 or http://dx.doi.org/10.2139/ssrn.3720206

This paper studies the impact of disclosure on short selling. Using a confidential dataset on shorts on stocks traded in the Dutch stock market including both short positions large enough to trigger public disclosure and positions not large enough, the authors find that the quality of shorts increases discontinuously at the reporting threshold. The paper shows strong evidence that short sellers increase security selection intensity when their short positions approach the reporting threshold. The authors rule out several alternative explanations including the explanation that positions reaching the reporting threshold move the market, the explanation that large short sellers have a higher quality of shorts, or the explanation that returns are time-varying and change discontinuously when positions reach the disclosure threshold. These results suggest transparency has an effect of disincentivizing shorting on noisy information**.**

Duong, Truong X. and Huszar, Zsuzsa R. and Huszar, Zsuzsa R. and Yamada, Takeshi, The Costs and Benefits of Short Sale Disclosure (October 29, 2014). Journal of Banking and Finance, Volume 53, Pages 124-139, 2015, Available at SSRN: https://ssrn.com/abstract=2297680 or http://dx.doi.org/10.2139/ssrn.2297680

This study examines the impact of a market-wide mandatory disclosure policy on short selling on the Tokyo Stock Exchange. It finds that average short selling slightly declined while investors' shorting strategies changed significantly in response to the disclosure. Previously highly shorted stocks were shorted less and shorting activity shifted toward smaller and riskier stocks, suggesting that retail investors became the more likely short sellers. Short sales became more trend-chasing, prices became less informative, and short-term price volatility increased. Overall, the pricing efficiency benefits of short selling declined after the mandatory disclosure policy.

Heater, John C. and Liu, Ye and Tan, Qin and Zhang, Frank, Does Mandatory Short Selling Disclosure Lead to Investor Herding Behavior? (November 3, 2022). ***Available at SSRN: https://ssrn.com/abstract=3923046 or http://dx.doi.org/10.2139/ssrn.3923046***

Prior literature documents that short sale activity clusters around mandated short sale position disclosures. This paper investigates two competing, yet non-mutually exclusive, hypotheses for this finding: herding- versus information-based trading. First, using an entropy-balanced matched sample of stocks, it finds that future firm-level short interest exhibits a significantly smaller reversal for stocks that had short-sale disclosures than for non-disclosure stocks. It also finds that the cumulative stock returns after the disclosure are lower for disclosure stocks relative to non-disclosure stocks in the short-run but recover over time. The recovery in stock prices for disclosure stocks is consistent with the initial excessive short-selling pressure abating and fundamental investors buying the dip, a result consistent with herding-based trading but inconsistent with information-based trading. Second, the paper explores the role of new information about firm fundamentals on short selling activities and find that the degree of short-sale disclosure clustering is similar across the pre-earnings announcement, post-earnings announcement, and no-news periods, regardless of whether the earnings news is good or bad,

suggesting that information shocks are not driving short-sale disclosure clustering. Overall, the evidence is consistent with short sellers herding into short positions after observing short-sale disclosures.

Jank, S., Roling, C. & Smajlbegovic, E. (2021) Flying under the radar: The effects of short-sale disclosure rules on investor behavior and stock prices. Journal of Financial Economics 139, no. 1 (2021): 209-233.

This research documents that a sizable fraction of investors are reluctant to disclose their short positions publicly. Just below the disclosure threshold, positions accumulate, exhibit an abnormally low probability of increasing, and remain unchanged for an abnormally long time. This reluctance to cross the publication threshold represents a short-sale constraint for a large fraction of investors. Consistent with the overpricing hypothesis, when the short-sale constraint imposed by the disclosure threshold is potentially binding, stocks exhibit negative abnormal returns of 1.0-1.4% on a monthly basis. Different placebo tests verify that the short-sale constraint originates from the disclosure rule. Overall, these findings suggest that the investors' reluctant behavior in response to the short-sale transparency regulation imposes negative externalities on stock market efficiency.

Jones, C.M., Reed, A.V. & Waller, W. (2016) Revealing shorts: An examination of large short position disclosures. The Review of Financial Studies, 29(12), pp.3278-3320.

By 2012, all European Union countries began requiring the disclosure of large short positions. This regime change reduced short interest, bid-ask spreads, and the informativeness of prices. After specific disclosures, short-run abnormal returns are insignificantly negative, but 90-day cumulative abnormal returns are a statistically significant –5.23%. We find disclosures are likely to be followed by other disclosures, especially when the initial discloser is large or centrally located, but there is no subsequent increase in short interest, and prices do not subsequently reverse. These results indicate that large short sellers are well-informed, and that disclosures are not being used to coordinate manipulative attacks.

Lunde, Jensen, Hauschultz and Tizik, Market Impact of Short Sale Position Disclosures (January 2018). Copenhagen Economics, Available at: http://www.copenhageneconomics.com/dyn/resources/Publication/publicationPDF/3/573/1626345387/market-impact-of-short-sale-position-disclosures.pdf

Consistent with earlier findings by the European Securities and Markets Authority (ESMA) and the German central bank (Bundesbank), this regression analysis reveals clear indications that public disclosures in the EU and UK cause herding behaviour, in which investors copy each other’s short positions. Following a required public disclosure for a given stock, the research finds an increase in daily volatility of 1.5 percent. The paper finds indications that the higher volatility is a result of an exaggerated downward price adjustment, as it finds that a required public disclosure leads to a reduction in daily returns of 0.06 percent.

Dr. Lunde, Jensen, Dr. Hauschultz, Tizik, Market Impact of Short Sale Position Disclosures (2021). Copenhagen Economics. Available at: https://www.copenhageneconomics.com/dyn/resources/Publication/publicationPDF/3/573/1626345387/market-impact-of-short-sale-position-disclosures.pdf.

In line with academic papers, as well as research papers by major European economic institutions, Copenhagen Economics empirically identified that public disclosure of short selling is likely to impair price discovery for two main reasons: 1) it deters informed investors from shorting assets, thereby

withholding information from the price discovery process and 2) it leads to herding behaviour, which is associated with a risk of exaggerated price adjustments and therefore higher volatility.

Saffi, Pedro, and Sigurdsson, Kari. *The Review of Financial Studies*, Volume 24, Issue 3, March 2011, Pages 821–852. Available at: https://academic.oup.com/rfs/article-abstract/24/3/821/1590469?redirectedFrom=fulltext.

This article presents a study of how stock price efficiency and return distributions are affected by short-sale constraints. The study is based on a global dataset, from 2005 to 2008, that includes more than 12,600 stocks from 26 countries. It presents two main findings. First, lending supply has a significant impact on efficiency. Stocks with higher short-sale constraints, measured as low lending supply, have lower price efficiency. Second, relaxing short-sales constraints is not associated with an increase in either price instability or the occurrence of extreme negative returns.

Siciliano, Gianfranco, and Ventoruzzo, Marco. Banning Cassandra from the Market? An Empirical Analysis of Short-Selling Bans during the Covid-19 Crisis (2020). European Company and Financial Law Review. Available at: https://pennstate.pure.elsevier.com/en/publications/banning-cassandra-from-the-market-an-empirical-analysis-of-short-.

During the recent COVID-19 pandemic crisis, stock markets around the world witnessed an abrupt decline in security prices and an unprecedented increase in security volatility. In response to a week of financial turmoil on the main European stock markets, some market regulators in Europe, including France, Austria, Italy, Spain, Greece, and Belgium, passed temporary short-selling bans in an attempt to stop downward speculative pressures on the equity market and stabilize and maintain investors' confidence. This paper examines the effects of these short-selling bans on market quality during the recent pandemic caused by the spread of COVID-19. The results suggest that during the crisis, banned stocks had higher information asymmetry, lower liquidity, and lower abnormal returns compared with non-banned stocks. These findings confirm prior theoretical arguments and empirical evidence in other settings that short-selling bans are not effective in stabilizing financial markets during periods of heightened uncertainty. In contrast, they appear to undermine the policy goals market regulators intended to promote.

Whitemore, Travis. An Academic View: The Effectiveness of Short-Selling Bans. Securities Finance Research, State Street Associates (2020). Available at: https://static.ecestaticos.com/file/ad5/2f1/824/ad52f18246a3e65f7edd400bf85f9d8f.pdf.

During times of financial turmoil, regulators will commonly try to stabilize market prices by implementing short-selling bans and restrictions. Academic findings and empirical evidence suggest that these measures have little to no effectiveness in preventing price declines, instead resulting in a degradation of market quality at a time when it is most crucial. Short-selling bans have been imposed throughout Europe and Asia in response to the economic fallout from COVID-19, but it is unlikely that similar bans will be put in place by US regulators given the limited effectiveness that these measures have.

U.S. SEC (2014). Short sale position and transaction reporting: As required by Section 417 of the Dodd-Frank Wall Street Reform and Consumer Protection Act. Technical report, U.S. Securities and Exchange Commission.

The Division studied the feasibility, benefits, and costs of a real-time short position reporting regime ("Real-Time Short Position Reporting") to the public or only to FINRA and the Commission and the feasibility, benefits, and costs of adding new, short sale-related marks to the Consolidated Tape ("Transaction Marking") in a voluntary pilot program ("Transaction Marking Pilot"). To assess the feasibility, benefits, and costs, the Division compared Real-Time Short Position Reporting and Transaction Marking to a baseline that includes currently available data as well as potential data from the prospective Consolidated Audit Trail ("CAT"). The Division concludes that none of these alternatives is likely to be cost-effective when compared to the baseline.

Short Selling's Positive Impact on Markets and the Consequences of Short-Sale Restrictions. Committee on Capital Markets Regulation. Available at: https://www.capmktsreg.org/wp-content/uploads/2018/09/CCMR-Statement-on-Short-Selling.pdf.

The academic evidence on the effects of short selling on capital markets is overwhelmingly positive. Short selling improves the efficiency of security prices, increases liquidity, and positively impacts corporate governance. Historical bans and restrictions on short selling have proved to negate many of these benefits, to the detriment of overall market quality. As policymakers evaluate proposals to mandate disclosure of individual short selling activity, the potential unintended consequences on market quality must be carefully considered.

An Introduction to Short Selling (2021). Managed Funds Association. Available at: https://www.managedfunds.org/research/an-introduction-to-short-selling/.

Short selling contributes significantly and demonstrably to healthy capital markets, which ultimately profits pension beneficiaries and supports job creation. Short sellers support reporting to the SEC and the disclosure of aggregate short positions in the market. Short sellers do not, however, want public reporting of individual investor positions. As starkly demonstrated by the Wirecard collapse, government efforts to restrain or ban short selling may actually shield the exposure of fraud and, in all cases, such intervention leads to deterioration of market quality. Changes to rules that would require individual investors to disclose short positions would lead to the same results, hurting investors and ultimately the competitiveness of U.S. markets.