EXPLANATORY MEMORANDUM TO

THE SHORT SELLING REGULATIONS 2025

2025 No. 29

1. Introduction

1.1 This explanatory memorandum has been prepared by the Treasury and is laid before Parliament by Command of His Majesty.

1.2 This memorandum contains information for the Joint Committee on Statutory Instruments.

2. Declaration

2.1 Tulip Siddiq MP, Economic Secretary to the Treasury, confirms that this Explanatory Memorandum meets the required standard.

2.2 Tom Duggan, Deputy Director, Securities and Markets, at the Treasury confirms that this Explanatory Memorandum meets the required standard.

3. Contact

3.1 Charlie Graham at the Treasury (MarketConduct@hmtreasury.gov.uk) can be contacted with any queries regarding the instrument.

Part One: Explanation, and context, of the Instrument

4. Overview of the Instrument

What does the legislation do?

4.1 When the UK left the EU, the body of EU legislation that applied directly in the UK at the point of exit was transferred onto the UK statute book by the European Union Withdrawal Act 2018. This is known as assimilated law.

4.2 The Financial Services and Markets Act 2023 (FSMA 2023) repeals assimilated law in financial services, subject to commencement. Assimilated law relating to financial services will be replaced with rules set by the financial services regulators, operating within a framework set by government and Parliament.

4.3 This instrument establishes a new legislative framework for the regulation of short selling, creating designated activities for short selling, giving the Financial Conduct Authority (FCA) rulemaking powers related to these activities and powers to intervene in exceptional circumstances.

4.4 Through the FCA taking on additional rulemaking responsibilities, financial services firms and consumers will benefit from agile, tailored rule-making that suits UK markets.

Where does the legislation extend to, and apply?

4.5 The extent of this instrument (that is, the jurisdiction(s) which the instrument forms part of the law of) is England and Wales, Scotland and Northern Ireland.

4.6 The territorial application of this instrument (that is, where the instrument produces a practical effect) is England and Wales, Scotland and Northern Ireland.

5. Policy Context

What is being done and why?

5.1 Short selling is the practice of selling a security that is borrowed or not owned by the seller with the intention of buying it back later at a lower price to make a profit. Short selling is regulated in the UK by the Short Selling Regulation (EU) No 236/2012 (the SSR). This is the UK version of the EU Short Selling Regulation (EU) No 236/2012 (the EU SSR), as incorporated into UK law by the European Union (Withdrawal Act) 2018.

5.2 Following a review of the SSR by the Treasury launched in December 2022, this instrument replaces assimilated law related to short selling, creating a new legislative framework for the regulation of short selling which provides the FCA with additional rulemaking powers.

What was the previous policy, how is this different?

5.3 The EU SSR was introduced in 2012, in response to concerns over the short selling of shares in financial institutions and the short selling of euro area sovereign debt, including through credit default swaps. At the time there were concerns from some about the lack of information and transparency to the market and authorities on whether and how short selling was impacting prices, exacerbating uncertainty and downward price movements, and potentially increasing risks to financial stability. To note, the UK already had a short selling regime before the SSR, which was repealed to implement the common regulatory framework across member states.

5.4 The SSR applied to financial instruments admitted to trading or traded on a UK trading venue (unless they are principally traded on a third country venue). The regulation also applied to UK sovereign debt and related credit default swaps. The SSR had several core provisions:

a) It required holders of net short positions in shares or sovereign debt to make notifications of their positions to the FCA once certain thresholds have been met, and to publicly disclose positions in shares once certain thresholds have been met.

b) It outlined restrictions on investors entering into uncovered short positions in shares or sovereign debt.

c) It allowed persons carrying out stabilisations or persons that meet the definition of a market maker to apply to the FCA to be exempt from restrictions on uncovered short selling and notification requirements (‘the market maker exemption’).

d) It provided the FCA with powers to restrict short selling in certain circumstances to prevent a disorderly decline in the price of a financial instrument or in response to a serious threat to financial stability or market confidence.

e) It contained buy-in procedures and late settlement requirements to ensure settlement discipline.

How is this different?

5.5 This instrument replaces the EU-inherited SSR regime with a model where the FCA generally sets the detailed rules that firms must adhere to, within a framework set by government and Parliament.

5.6 The instrument maintains an overarching regulatory framework to facilitate short selling and the benefits it provides to the orderly and effective functioning of the

markets, while protecting against risks. The instrument restates core definitions relevant to the short selling regime and gives the FCA broad rulemaking powers. This includes the ability to set requirements like restrictions on uncovered short selling, such as borrowing and locate arrangements. It also restates the requirement for firms to notify the FCA of net short positions above 0.2% of issued share capital. The Treasury retains the power to amend this threshold, but the FCA may require notifications at a different threshold in exceptional circumstances.

Substantive policy changes

5.7 This instrument makes a series of substantive changes to the regulatory regime for short selling, implementing the changes to the short selling regime announced in July 2023 in the government response to the Short Selling Regulation Review and in November 2023 in the government response to the consultation on aspects of the SSR related to sovereign debt and credit default swaps. The key ones are set out here.

5.8 First, this instrument requires the FCA to publish anonymised aggregated net short positions based on all individual position notifications it receives. This is a change to the SSR where the firms were required to publish individual net short positions above 0.5% of issued share capital.

5.9 Second, the SSR contained various provisions related to sovereign debt and sovereign credit default swaps (SCDS). As announced previously, this instrument does not include restrictions on uncovered short selling of sovereign debt and SCDS or sovereign debt notification requirements. However, this instrument does maintain emergency intervention powers for sovereign debt and SCDS in the same way as other financial instruments.

Changes to establish a more effective framework

5.10 This instrument also makes a number of changes which do not represent a substantive policy change but establish a framework for regulating short selling that is in line with an approach in which detailed firm-facing requirements are set by the regulators.

5.11 The SSR exempted shares admitted to trading on a UK trading venue that are principally traded outside the UK from various requirements, including reporting requirements and restrictions on uncovered short selling. This instrument instead gives the FCA the power to exempt shares from requirements where it considers it appropriate to do so and requires the FCA to publish a list of shares that the FCA considers are subject to their rules. This list will set out the shares the FCA considers to be in scope, a change from the SSR where the FCA publishes a list of shares it considers to be exempt from the regime. This means that the designated activities for short selling in this instrument have a broader scope of shares traded on a UK trading venue and related instruments, with the intention that the FCA may further narrow the scope of instruments to which the regulatory requirements apply.

5.12 The SSR included a market maker exemption. This instrument provides the FCA with a rulemaking power to exempt market making activities and stabilisations from short selling-related requirements, in effect allowing the FCA to create a market maker exemption.

5.13 Under the SSR, the Treasury had the power to determine other jurisdictions to be equivalent for the purposes of the market maker exemption. This instrument creates a framework to allow the Treasury to make a designation in relation to non-UK jurisdictions. The Treasury can make designations when doing so is compatible with specified matters relating to the UK's financial system and economy, which are set

out in this instrument. This framework allows market makers to either use membership of a UK trading venue or a trading venue in an overseas jurisdiction in relation to which the Treasury has made a designation to qualify for any exemption framework provided for in FCA rules, subject to any further conditions or restrictions imposed by the FCA for market makers. The instrument also restates an existing SSR overseas determination for the European Economic Area (EEA) States, including the EU, and so market makers who are members of trading venues in the EEA States will continue to qualify for any FCA exemption framework.

5.14 This instrument maintains the FCA's powers to intervene in exceptional circumstances, including powers to request information and prohibit or impose conditions on short sales and related transactions. Unlike the SSR, the instrument also requires the FCA to publish a statement of policy setting out further detail of how it would use these intervention powers.

5.15 This instrument and the Financial Services and Markets Act 2000 (Designated Activities) (Supervision and Enforcement) Regulations 2025 – laid at the same time as this instrument – also make provision to replace the FCA's existing SSR supervisory and enforcement powers with powers to supervise and enforce the new regime. This instrument makes the necessary consequential amendments to other legislation as well as saving provision. For example, this instrument saves Article 26(3) of Regulation (EU) No 600/2014[1] to maintain the status quo for transaction reporting requirements related to sovereign debt. Certain interdependencies between this instrument and the Financial Services and Markets Act 2000 (Designated Activities) (Supervision and Enforcement) Regulations 2025 are explained below in section 11 (matters of special interest to Parliament).

6. Legislative and Legal Context

How has the law changed?

6.1 The assimilated law that concerns short selling, and is therefore being replaced by this instrument, includes:

- Regulation (EU) No 236/2012 of the European Parliament and of the Council of 14 March 2012 on short selling and certain aspects of credit default swaps, as it has been assimilated in UK law following EU Exit.
- Commission Delegated Regulation (EU) No 918/2012 of the European Parliament and of the Council on short selling and certain aspects of credit default swaps with regard to definitions, the calculation of net short positions, covered sovereign credit default swaps, notification thresholds, liquidity thresholds for suspending restrictions, significant falls in the value of financial instruments and adverse events.

6.2 FSMA 2023 establishes a number of new legislative powers for the government to replace and amend assimilated law, where necessary.

6.3 Section 1 of FSMA 2023 repeals assimilated law relating to financial services, listed in Schedule 1 to that Act, subject to commencement by the Treasury. A separate commencement instrument will commence the repeal of assimilated law and technical standards relating to short selling, including the legislation mentioned in paragraph 6.1.

[1] Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments.

6.4 This instrument exercises powers in Part 5A of FSMA 2000 – the Designated Activities Regime (DAR). The DAR was inserted into FSMA 2000 by FSMA 2023 in order to provide a proportionate framework for regulating activities related to financial markets, exchanges, instruments, products or investments, including those currently regulated through assimilated law.

6.5 In accordance with the role that the Treasury has in setting the perimeter of financial services regulation, Part 5A of FSMA 2000 gives the Treasury the power to designate an activity in order to bring it into regulation under the DAR. The FCA has powers for making rules related to each designated activity, as described further in the instrument. Any person conducting a designated activity will be required to follow the rules and regulations related to it.

6.6 Section 4 of FSMA 2023 contains a power to restate assimilated law into domestic legislation as it had effect immediately before its repeal. Section 4 also permits the Treasury to modify the legislation that is being restated where it considers that to be necessary or desirable for or in connection with one or more of a specified set of purposes. These purposes include promoting effectiveness in the functioning of financial markets, facilitating the international competitiveness of the UK economy and its growth in the medium to long term, and providing for efficient and effective regulatory and supervisory arrangements. This instrument uses the powers in section 4 of FSMA 2023 to restate the following provisions with appropriate modifications, which are aligned to those purposes:

- The threshold for reporting net short positions to the FCA.
- A requirement for the FCA to publish aggregate net short positions.
- A requirement for the FCA to publish a list of shares it considers to be in scope of the regime.
- A requirement for the FCA to publish a list of persons who are using an exemption related to market making or stabilisations.
- Powers for the FCA to intervene in exceptional circumstances.
- The overseas trading venue short selling regimes, including the existing determination for EEA states.
- Buy-in procedures.

Why was this approach taken to change the law?

6.7 This is the only possible approach to make the necessary changes, as current regulation is in statute, and so its replacement also needs to be in statute.

7. Consultation

Summary of consultation outcome and methodology

7.1 In December 2022 the government published a Call for Evidence on the SSR.[2] The government published a response to this Call for Evidence in July 2023, setting out the government's intended approach to reforming the UK short selling regime.[3] Alongside this, the government published a consultation on the regulation of

[2] https://assets.publishing.service.gov.uk/media/63ceb7f08fa8f53fdc964878/SSR_CfE_-_Official_Publication__FINAL_.pdf

[3] https://assets.publishing.service.gov.uk/media/64ad3e4fe1aab2000c03ad4c/Short_Selling_Regulation_Review_-_Government_response__1.pdf

sovereign debt and credit default swaps under the short selling regime.[4] The government published the response to this consultation,[5] alongside a draft of this instrument alongside a draft of this instrument in November 2023.[6] The government welcomed technical legal comments on the draft instrument by 10 January 2024.

7.2 Responses to the draft instrument came from one financial services industry body and one individual, which primarily aimed to clarify the legal drafting to ensure it meets the policy intent. Comments on the draft instrument were carefully considered by the Treasury and addressed in the final instrument where appropriate.

8. Applicable Guidance

8.1 No guidance accompanies this instrument.

Part Two: Impact and the Better Regulation Framework

9. Impact Assessment

9.1 A full impact assessment has not been prepared for this instrument because, in line with Better Regulation guidance, HM Treasury considers that the net impact of this instrument on business will be less than £10m Equivalent Annual Net Direct Costs to Business. Due to this limited impact, a de minimis Impact Assessment is submitted with this memorandum and published alongside the Explanatory Memorandum on the legislation.gov.uk website.

Impact on businesses, charities and voluntary bodies

9.2 There is no, or no significant, impact on business, charities or voluntary bodies.

9.3 The legislation applies to all businesses who engage in short selling activity, including small or micro businesses. This approach is appropriate to ensure the UK's regulatory framework for short selling supports effective market functioning with appropriate protections for investors.

9.4 This instrument places several requirements on the FCA, but there is no significant impact on the public sector.

10. Monitoring and review

What is the approach to monitoring and reviewing this legislation?

10.1 The approach to monitoring this legislation is engagement with industry to understand its initial and ongoing impact. FSMA 2000 also requires the regulators to keep under review any rules they have made.

10.2 The instrument does not include a statutory review clause and, in line with the requirements of the Small Business, Enterprise and Employment Act 2015 Tulip Siddiq, Economic Secretary to the Treasury made the following statement:

"It is not proportionate to include a review clause in this instrument because the estimated annual net direct cost to business is less than £10 million."

[4] https://assets.publishing.service.gov.uk/media/64abfc4e112104000cee65a5/Short_Selling_Regulation_Review_-_sovereign_debt_and_CDS_consultation_document__1_.pdf

[5] https://assets.publishing.service.gov.uk/media/6558e0be544aea000dfb2fc1/M8212_-_Short_Selling_Regulation_-_government_response_to_sovereign_debt_and_CDS_consultation.pdf

[6] https://www.gov.uk/government/publications/short-selling-regulations-2024

Part Three: Statements and Matters of Particular Interest to Parliament

11. Matters of special interest to Parliament

11.1 There are interdependencies between certain provisions of this instrument, the Consumer Composite Investments (Designated Activities) Regulations 2024 and the Financial Services and Markets Act 2000 (Designated Activities) (Supervision and Enforcement) Regulations 2025. Those interdependencies, and the steps being taken to manage them, are described in more detail below.

11.2 The Financial Services and Markets Act 2000 (Designated Activities) (Supervision and Enforcement) Regulations 2025 – specifically some of the amendments to the Financial Services and Markets Act 2000 ("FSMA 2000") made by those Regulations – refers expressly to the Short Selling Regulations 2025 in order to apply those amendments to the regime for the regulation of designated activities relating to short selling, which is established by this instrument. The amendments made by the Financial Services and Markets Act 2000 (Designated Activities) (Supervision and Enforcement) Regulations 2025 also refer expressly to the Consumer Composite Investments (Designated Activities) Regulations 2024 for similar reasons.

11.3 This instrument in turn refers expressly to some of the new material inserted into FSMA 2000 by the Financial Services and Markets Act 2000 (Designated Activities) (Supervision and Enforcement) Regulations 2025. This instrument relies in part on powers in Part 5A of FSMA 2000 to specify certain activities relating to short selling as designated activities and to make further provision about such activities; and it relies in part on section 4 of the Financial Services and Markets Act 2023 ("FSMA 2023"), which permits the Treasury to make provision restating and modifying assimilated law revoked by section 1 of, and Schedule 1 to, FSMA 2023 (in this case Regulation (EU) No 236/2012 of the European Parliament and of the Council of 14 March 2012 on short selling and certain aspects of credit default swaps).

11.4 The section 4 restatement portion of this instrument includes provision applying a number of provisions of FSMA 2000 (with modifications where appropriate) in order to deal with matters such as enforcement by the Financial Conduct Authority ("FCA"). In the case of the Part 5A portion of this instrument, equivalent matters will be dealt with by the amendments which the Financial Services and Markets Act 2000 (Designated Activities) (Supervision and Enforcement) Regulations 2025 make to FSMA 2000. So that the FCA has consistent powers for enforcement activity relating to both portions of this instrument, the Financial Services and Markets Act 2000 (Designated Activities) (Supervision and Enforcement) Regulations 2025 expressly apply some of the new material inserted into FSMA 2000 by the Financial Services and Markets Act 2000 (Designated Activities) (Supervision and Enforcement) Regulations 2025.

11.5 The Short Selling Regulations 2025 have been laid in draft at the same time as the Financial Services and Markets Act 2000 (Designated Activities) (Supervision and Enforcement) Regulations 2025; the Consumer Composite Investments (Designated Activity) Regulations 2024 were laid in draft on 10 October 2024. Given that the Financial Services and Markets Act 2000 (Designated Activities) (Supervision and Enforcement) Regulations 2025 rely on those other two sets of Regulations, the Treasury will make the Financial Services and Markets Act 2000 (Designated Activities) (Supervision and Enforcement) Regulations 2025 only if Parliament approves those other Regulations. Moreover, given that the Short Selling Regulations 2025 rely on the Financial Services and Markets Act 2000 (Designated Activities)

(Supervision and Enforcement) Regulations 2025, the Treasury will make the Short Selling Regulations 2025 only if Parliament approves the Financial Services and Markets Act 2000 (Designated Activities) (Supervision and Enforcement) Regulations 2025. The Treasury will make the Short Selling Regulations 2025 and the Financial Services and Markets Act 2000 (Designated Activities) (Supervision and Enforcement) Regulations 2025 on the same day so that they come into force (in the case of this instrument, in part, and in the case of the Financial Services and Markets Act 2000 (Designated Activities)(Supervision and Enforcement) Regulations 2025, in full) at the same time at the beginning of the day after that on which they are made.

12. European Convention on Human Rights

12.1 The Economic Secretary to the Treasury, Tulip Siddiq MP, has made the following statement regarding Human Rights:

"In my view the provisions of the Short Selling Regulations 2025 are compatible with the Convention rights."

13. The Relevant European Union Acts

13.1 This instrument is not made under the European Union (Withdrawal) Act 2018, the European Union (Future Relationship) Act 2020 or the Retained EU Law (Revocation and Reform) Act 2023 ("relevant European Union Acts"). It does however relate to the withdrawal of the United Kingdom from the European Union because this instrument replaces assimilated law using powers in FSMA 2023.