

FCA Fines Non-UK Asset Manager in the First UK Enforcement Action Taken under the Short Selling Regulation

Client Alert | November 10, 2020

The UK Financial Conduct Authority (the “**FCA**”) has published a final notice (the “**Final Notice**”) detailing enforcement action taken against a Hong Kong asset manager for short selling disclosure rule breaches under the Short Selling Regulation (the “**SSR**”). The Final Notice provides a reminder to non-UK based asset managers of the extra-territorial reach of the SSR when trading in the UK and EU markets and of the need to ensure that they have the systems and controls in place to comply with the SSR. This client alert provides our clients with a refresher on the SSR and the key takeaways from this enforcement action.

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Key takeaways

- All firms trading in the UK and EU markets should maintain systems and controls to ensure ongoing compliance with the SSR. This will involve monitoring developments in the parallel UK and EU versions of the SSR after the end of the current Brexit transition period.
- Non-UK / non-EU investors can be caught by the provisions of the SSR as the rules have extra-territorial effect.
- The FCA has shown a willingness to take enforcement action against non-UK investors for breaches of the SSR, even if that investor only trades infrequently in the UK.
- The FCA specifically identified as an aggravating feature the failure of the firm to notify it as soon as it realised there was an issue.

What is the SSR?

The SSR came into force on 1 November 2012 and is intended to provide a harmonised framework for requirements and regulatory powers relating to short selling and entering into sovereign credit default swaps (“**CDS**”). In summary, the SSR:

- requires investors to notify the relevant national competent authority (“**NCA**”) of any net short positions in EU sovereign debt instruments and shares admitted to a trading venue in the EU;
- restricts uncovered short sales of shares and EU sovereign debt instruments;
- prohibits the entry into uncovered sovereign CDS; and
- provides NCAs and the European Securities and Markets Authority (“**ESMA**”) with powers to, amongst others, suspend or prohibit short selling.

The SSR has extra-territorial effect and ESMA has confirmed that the location of a transaction and the domicile or location of the parties to the transaction are irrelevant when assessing whether or not the SSR applies.

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This client alert will focus on the requirement of investors to notify the relevant NCA of the net short positions they hold with respect to in-scope shares. For these purposes, “in-scope shares” are the shares of companies admitted to trading on a regulated market or a multilateral trading facility and derivatives relating to such financial instruments.

Why is short-selling reporting regarded by regulators as being important?

In September 2020, the FCA published Market Watch 63, the latest version of its periodic newsletter on market conduct and transaction reporting issues. Market Watch 63 reiterated the FCA’s view that it considers that short selling can contribute usefully to liquidity and price discovery, and therefore support open, effective markets that operate with integrity. However, the FCA stated that it is important that market participants ensure that they continue to meet their obligations under the SSR as this gives appropriate transparency to short selling activity and support the orderly functioning of the market.

What are the SSR notification thresholds for in-scope shares?

The SSR sets out transparency requirements for net short positions in relevant shares. There are two types of disclosure, private and public.

Private disclosure

An investor must notify the relevant NCA of a net short position it has in relation to in-scope shares:

- when the position reaches 0.2% **(note COVID-related developments below)** of the issued share capital of the company;
- at each additional 0.1% above the 0.2% threshold; and
- when the position decreases below either of the above disclosure thresholds.

Public disclosure

An investor must notify the relevant NCA of a net short position it has in relation to in-scope shares:

- when the position reaches 0.5% of the issued share capital of the company;
- at each additional 0.1% above the 0.5% threshold; and
- when the position decreases below either of the above disclosure thresholds.

What is the method and timing of private and public disclosures?

In the UK, the FCA has confirmed that disclosures of net short positions should be made by sending a completed notification form to it by email. A disclosure must be made by 3.30 pm on the trading day following the day on which the person reaches, falls below or passes through the relevant threshold. The key difference is that the SSR requires public disclosures to be published on a website maintained by the relevant NCA.

Will Brexit have an impact on the SSR as implemented in the UK?

The SSR, an EU regulation, is directly applicable and will form part of UK law at the end of the Brexit transition period under the European Union (Withdrawal) Act 2018. The SSR will be amended in the UK to ensure that it will operate effectively after 31 December 2020. There will, therefore, be two versions post-transition period, the EU SSR and the UK SSR. Investors will need to ensure that they have systems and controls in place to comply with both the EU SSR and the UK SSR.

Has COVID had an impact on the reporting thresholds?

On 16 March 2020, ESMA issued a decision to temporarily amend the threshold for notifying net short positions to NCA under the SSR from 0.2% of issued share capital to **0.1%**. The FCA confirmed that this decision would apply in the UK. However, the FCA stated that systems changes would be required and firms should continue to report at the

previous thresholds until further notice. On 31 March 2020, the FCA confirmed that the required changes to its systems had been made and that it would be ready to receive notifications at the lower threshold from 6 April 2020. Firms were not required to amend and resubmit notifications submitted to the FCA between 16 March 2020 and 3 April 2020.

On 11 June 2020, ESMA issued a decision renewing its original decision on 16 March 2020 amending the threshold from 17 June 2020 for a period of 3 months. On 16 September 2020, ESMA further renewed the March decision from 18 September 2020 for another period of 3 months. Firms should continue reporting at the lower threshold to the relevant NCA.

What enforcement action has the FCA taken?

On 14 October 2020, the FCA published the Final Notice it issued to Asia Research and Capital Management Ltd (“**ARCM**”), fining it £873,118 for breaches of short selling disclosure rules under the SSR. ARCM is a Hong Kong-based asset manager that trades infrequently in EU markets.

From February 2017 to July 2019, ARCM failed to make 155 notifications to the FCA and 153 disclosures to the public of its net short position in a UK listed company. By July 2019, ARCM had built a net short position equivalent to 16.85% of the issued share capital of the UK listed company. This position was held for a further 106 trading days before being notified to the FCA and disclosed to the public. ARCM agreed to resolve the matter and qualified for a 30% discount under the FCA’s executive settlement procedures.

The FCA considered the failings to be particularly serious given:

- the failures to comply with its obligations under the SSR were multiple and occurred over a long period of time;
- ARCM did not inform it promptly on discovering its failure and instead notified it only after it had reviewed and collated the relevant data for disclosure; and
- the size of the position was the largest net short position held in an issuer admitted to the FCA's Official List with shares admitted to trading on the Main Market of the London Stock Exchange.

What steps should firms be taken to ensure ongoing compliance?

The enforcement action against ARCM demonstrates that the FCA is willing to take action against investors for breaches of the SSR, even if that investor only trades infrequently in the UK. All firms trading in the UK and EU markets should maintain systems and controls to ensure ongoing compliance with the SSR. Firms would be well advised to undertake a review of their current systems and controls. This will involve monitoring developments in the parallel UK and EU versions of the SSR after the end of the current Brexit transition period.

Gibson Dunn’s lawyers are available to assist in addressing any questions you may have regarding these developments. Please contact the Gibson Dunn lawyer with whom you usually work in the firm’s Financial Institutions practice group, or the following authors in London:

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