



SECURITIES AND  
FUTURES COMMISSION  
證券及期貨事務監察委員會

# OECD-ADBI Roundtable on Capital Market Reform in Asia, Tokyo

## Session 3.1.2 Measures taken by supervisors or regulators – short selling restrictions

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# Outline of remarks

- 1. What triggered the ban on short selling in major markets?**
- 2. What was the impact of the ban on major stock markets?**
- 3. What was the situation in Hong Kong?**
- 4. What are the international efforts on short selling?**

# 1. What triggered the ban on short selling?

- **In mid-Sept 2008, Lehman's collapse and the continued sharp fall of the stock prices of many large financial institutions in the US and UK shook market confidence in the financial soundness of these companies**
- **Frustrated the attempts of financial institutions to raise new capital and authorities' efforts to manage the financial crisis**
- **Vicious circle**
  - Short selling accelerates the rapid fall of stock prices
  - As stock prices fall, market value of financial institutions shrinks rapidly, making capital raising impossible
  - Ratings downgrade leads to further sale of stocks
  - Loss of market confidence in the financial institutions leads to a run on them
- **US and UK introduced temporary measures to ban short selling, and this triggered similar actions by other market authorities**



# Temporary restrictions on short selling with particular focus on financial stocks

Australia	Banned all short selling temporarily with certain exemptions
Canada	Prohibited short selling of all TSX-US interlisted stocks (with one exception)
France	Prohibited naked short sales of 15 credit institutions and insurance companies
Germany	Prohibited short sales of 11 financial sector companies
Netherlands	Prohibited naked short sales of 8 financial companies
UK	Prohibit creating new or increasing existing short positions in 32 financial companies.
US	Short selling for over 1,000 financial companies

# IOSCO press release on 2 October 2008

- **Acknowledge short selling plays an important role in financial markets**
  - Provide more efficient price discovery
  - Mitigate market bubbles
  - Increase market liquidity
  - Facilitate hedging and risk management activities
  - Limit upward market manipulations
- **However, short selling may be problematic in the midst of a loss in market confidence**
  - A decrease in share price induced by short selling may lead to credit tightening for listed companies leading to bankruptcy
  - Short selling can be used as a tool to mislead the market e.g. spreading lies about a company's negative prospects

## 2. What was the impact of the ban on major stock markets?



Source: Bloomberg

# Performance of major stock markets since the ban

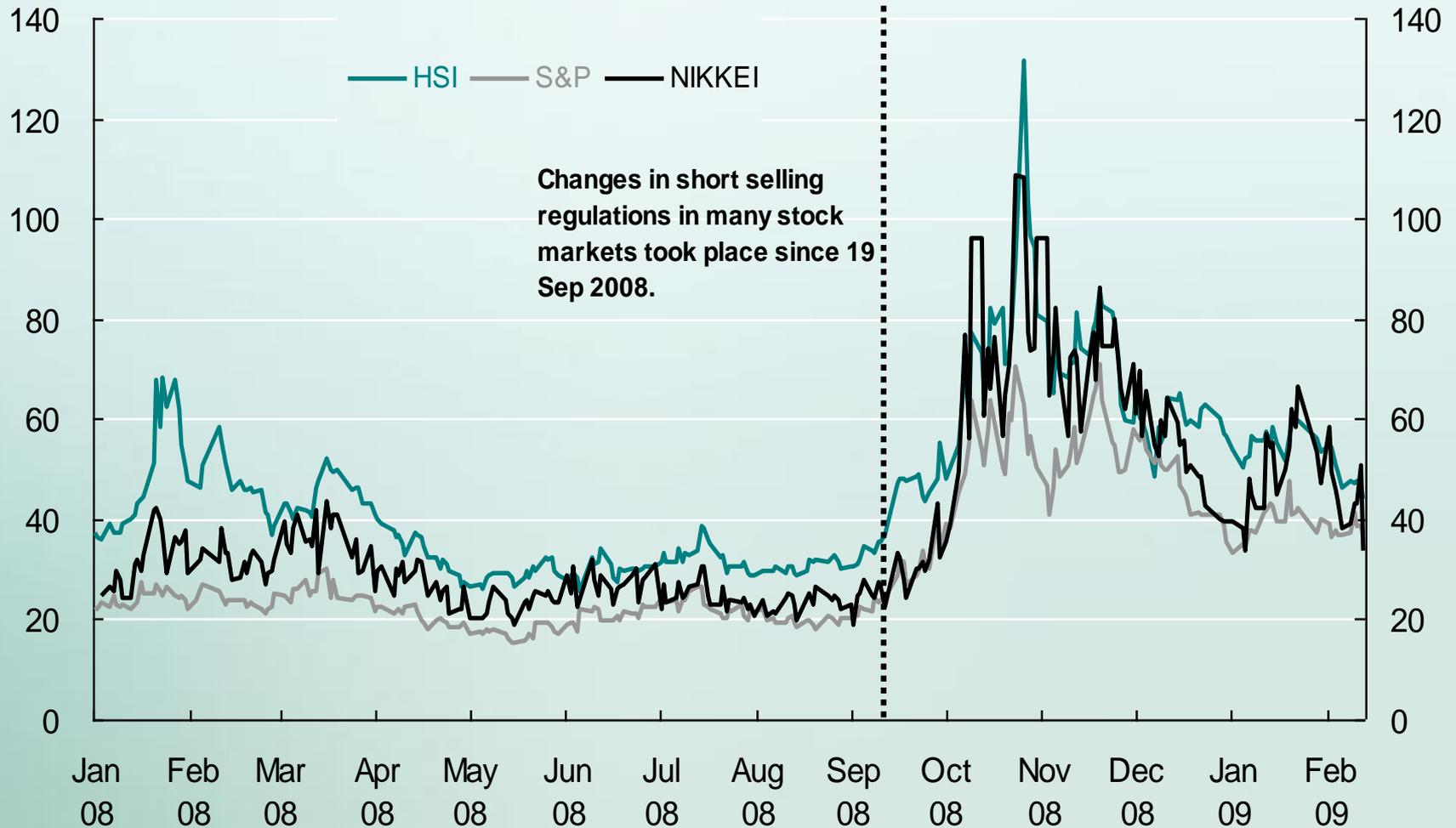
		end Jan 09	% Change since 19 Sep 08	Average Daily Trading (US\$ mn)		
		Index Level		Sep 08	Jan 09	% change
HK	-HSI	13,278.2	-31.3%	6,670.2	4,483.2	-32.8%
	-HSI - Finance	19,088.1	-38.9%			
Japan	-Nikkei	7,994.1	-32.9%	22,493.5	15,883.2	-29.4%
	-Nikkei Bank Index	1,224.3	-21.6%			
US	-Dow Jones Industrial	8,000.9	-29.7%	172,976.2	75,880.8	-56.1%
	-S&P 500	825.9	-34.2%			
	-S&P 500 Financials	124.0	-59.2%			
UK	-FTSE 100	4,149.6	-21.9%	25,166.5	11,483.4	-54.4%
	-FTSE Bank Index	3,056.7	-56.1%			

Remark: Changes in short selling regulations in many stock markets took place since 19 Sep 2008.

Source: Bloomberg and WFE



# Implied Volatilities of Major Stock Markets



Source: Bloomberg

# Impact of the ban on market functioning and investors

- **London Stock Exchange commissioned study found that restricting short selling had a negative effect on market efficiency and orderly trading**
- **Based on FTSE 100 companies subject to ban vs. FTSE 100 securities not subject to ban (control stocks), Capital Markets CRC Limited found:**
  - Spreads of banned stocks increased 150% greater than control stocks
  - Depth of banned stocks deteriorated 37% greater than control stocks
  - Trades and volume fell 10% in the banned stocks, but rose 50% in control stocks
  - Turnover fell 21% for banned, but rose 41% for control stocks
  - Liquidity deteriorated significantly much more for banned stocks
- **Alternative investment funds were unable to execute shorting strategies, causing significant losses to their investors**



### 3. What was the situation in Hong Kong?

- Existing short-selling regime in Hong Kong stricter
  - Naked short selling is prohibited
  - Only covered short selling is allowed
  - Can only short sell in a rising market (no selling below current best ask price – tick rule)

Short selling regime before temporary measures	Hong Kong	US	UK	Australia	Singapore
Prohibition of naked short selling?	Yes	Yes	No	No (a)	No
Eligibility list for short selling?	Yes	No	No	No	No
Tick rule?	Yes	No	No	Yes	No
Disclosure of aggregate open short positions per stock?	No	Yes	No	Yes (b)	No

Source: Riskmetrics, IOSCO, and various stock exchanges

Remarks:

(a) Naked short selling permissible in Australia subject to stock eligibility rules

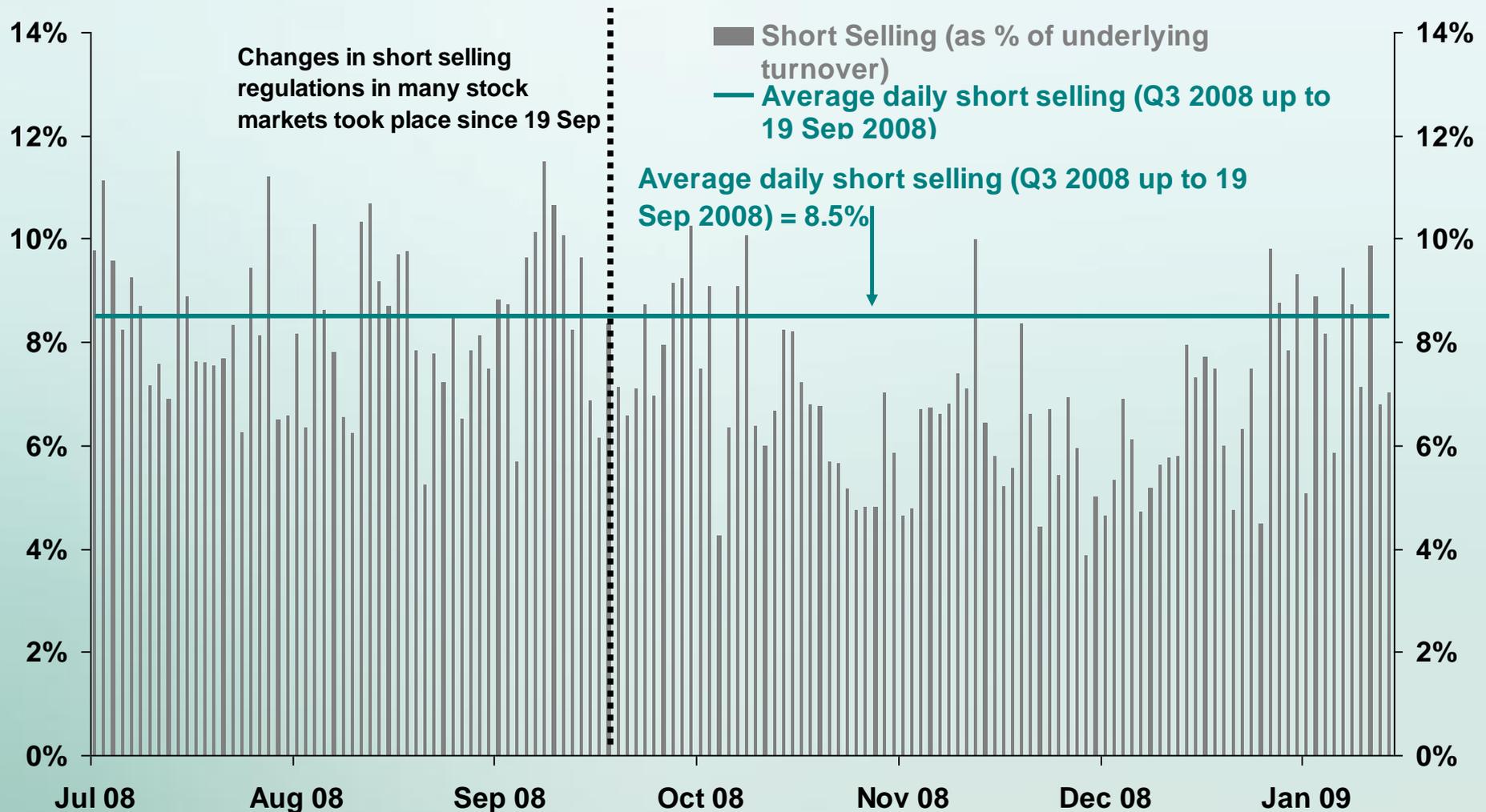
(b) Aggregate net open position



# Following double-play attack on the HK dollar in 1997, short selling regulation was tightened

- **Increased penalties on illegal short selling (naked short selling)**
- **Introduced an offence of unreported short selling by brokers**
  - Brokers were required to confirm with clients whether the short selling orders were “covered” prior to order placement
- **Reinstated the uptick rule on 7 September 1998**
  - Uptick Rule: a short sale cannot be made below the best current ask price
- **Reviewed the Designated Securities allowed for short selling on a quarterly basis**
  - Only securities with reasonable liquidity were permitted for short selling
- **Strictly enforced T+2 settlement (compulsory buy-in on T+3)**
- **Imposed penalties on settlement failures (default fee of 0.25%)**

# Short Selling Turnover in Hong Kong since July 2008



Remark: Changes in short selling regulations in many stock markets took place since 19 Sep 2008.  
Source: SFC Research

## 4. What are the international efforts on short selling?

- **IOSCO Technical Committee established a Task Force on Short Selling to look into**
  - Eliminating gaps in various regulatory approaches to naked short selling, delivery requirements and disclosure of short positions
  - Developing high-level principles for the effective regulation of short selling
- **Committee of European Securities Regulators (CESR) Task Force on Short Selling**
  - Assess the impact of the measures that were introduced by CESR Members
  - Consider the range of policy options for taking a more convergent approach
  - Enhance the coordination and cooperation between CESR Members on the decisions adopted at national level
- **Many jurisdictions are also reviewing their short selling regime, e.g. Australia, Hong Kong, UK, US**

**Thank you**

