

Short Selling against the backdrop of

- The Financial Crisis
- The COVID Crisis
- The „Meme Stock“ Short Squeeze

What is a short sale?



Short selling is the sale of a security the seller does not own at the time of entering into the agreement with the intention of buying it back at a later point in time in order to deliver it.

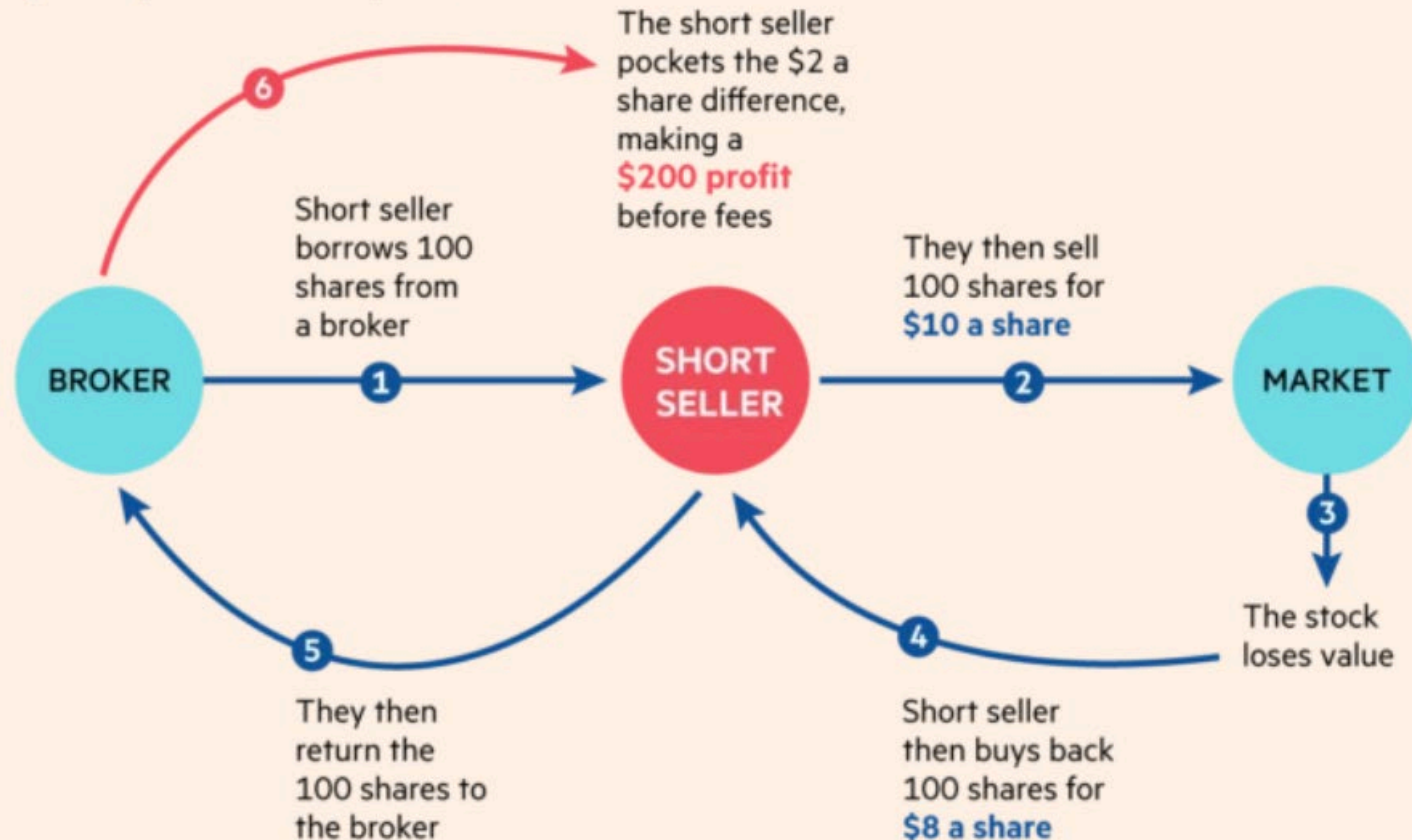
It can be divided into 2 types

- covered short selling is where the seller has made arrangements to borrow the securities before the sale
- naked short selling is where the seller has not borrowed the securities when the short sale occurs

What is a short sale, step by step

How does short selling work?

Making money from a fall in price



Short Selling – Economic background

- Economic efficiency of short sales
 - Short sellers are motivated by fundamentals and skilled in identifying overvalued stock
 - They provide information to the market, hence further accurate asset pricing
 - They keep up trading volume, hence lower transaction costs for all
 - They lessen the impact of bubbles
- Risks of short sales
 - Risk of short sales coupled with market manipulation/predatory shorts
 - In situations of high volatility ...
 - downward market moves can be artificially exacerbated
 - Irrational investor behavior can be intensified
 - Investor confidence can be lost

Short Selling Bans during the Financial Crisis

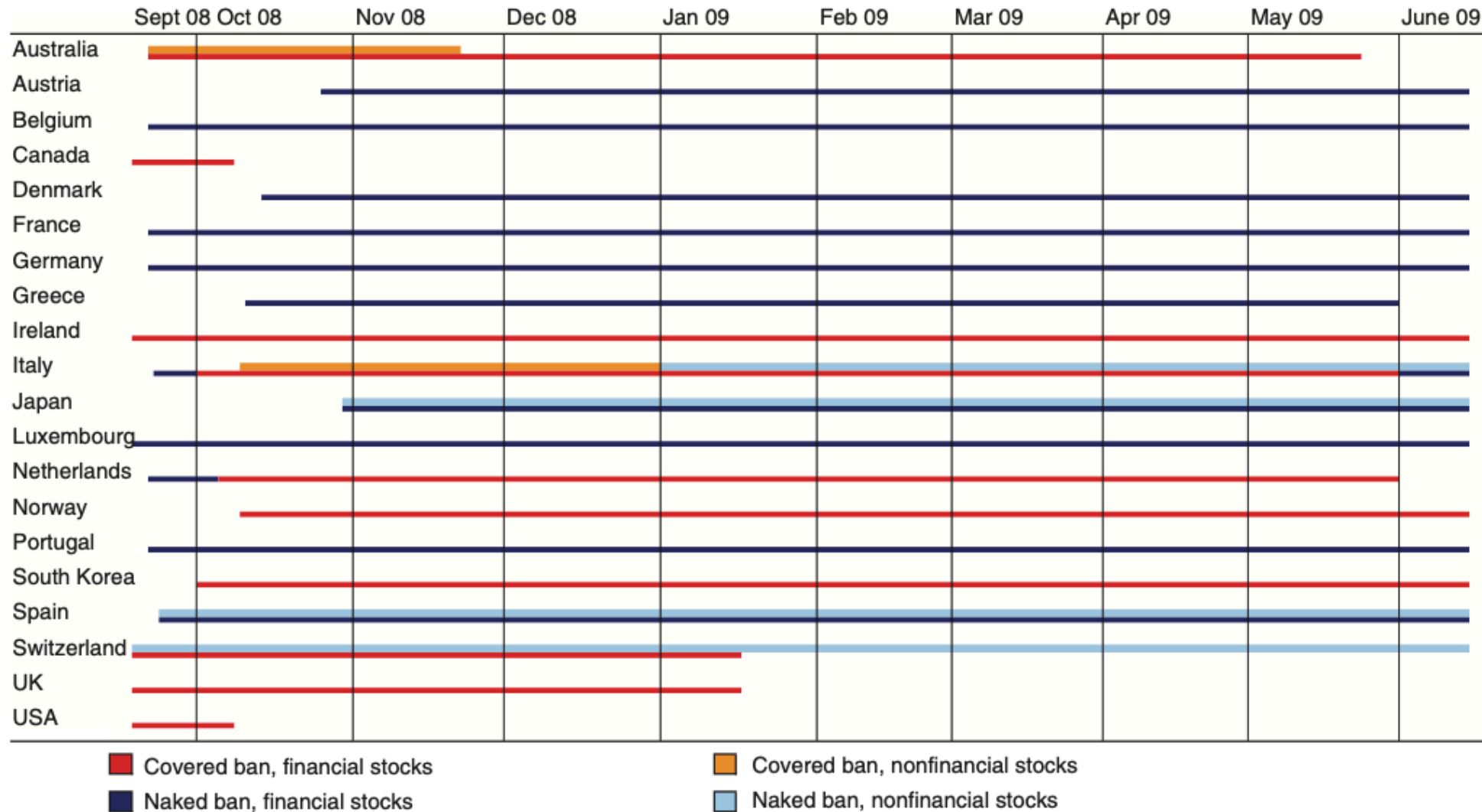


Figure 1. Short-selling ban regimes around the world, September 2008 to June 2009.

Source:
 Beber/Pagano,
 Journal of
 Finance 2013,
 343

Short Selling Bans during the Financial Crisis

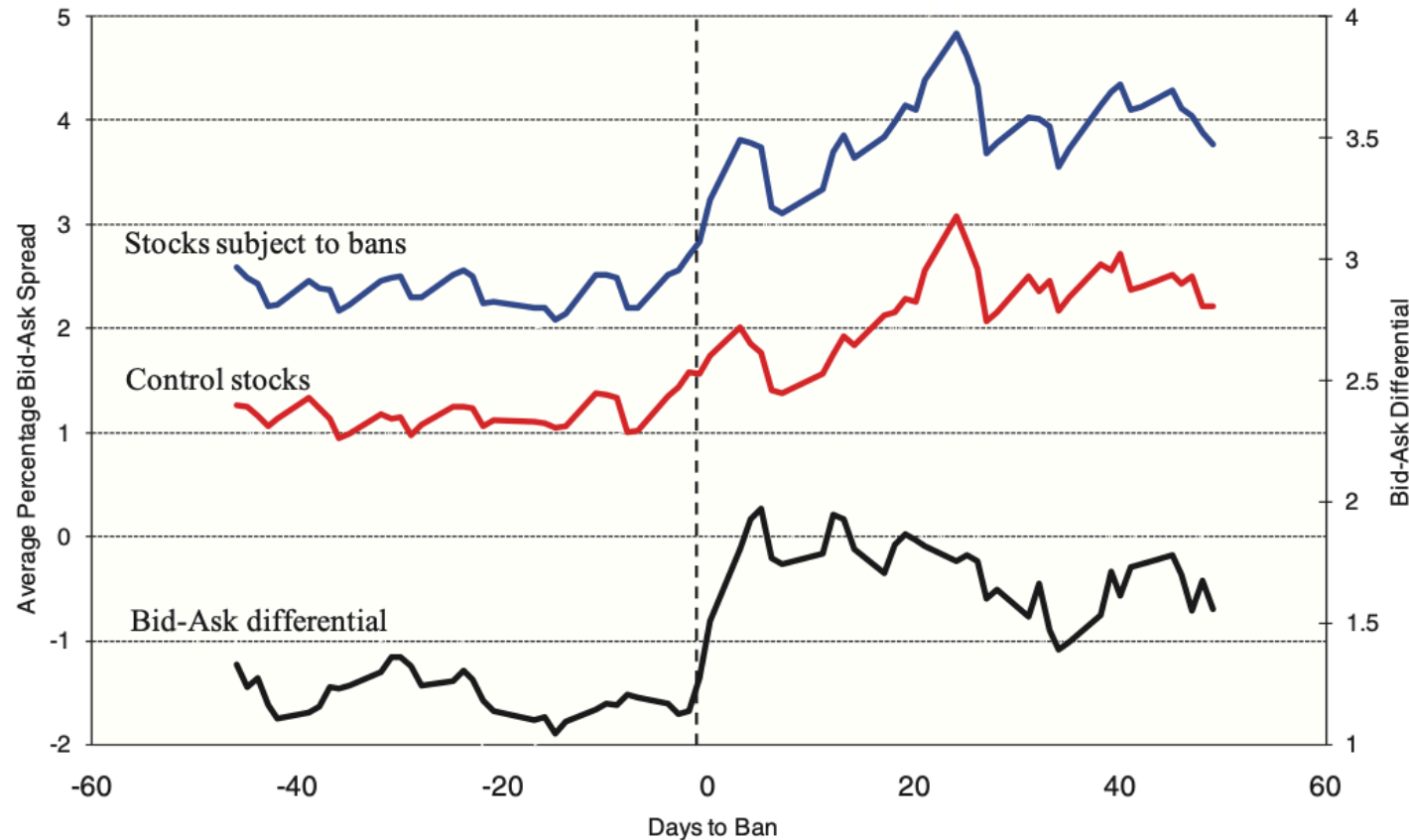


Figure 4. Average bid-ask spread of stocks subject to bans and of matched exempt stocks for countries with partial bans. The lines plots the 3-day moving average of the bid-ask spread's cross-sectional average for stocks subject to bans and control stocks (left scale) and their differential (right scale), in a 50-day window around the ban inception date (date 0). The data correspond to countries with partial bans: Belgium, Canada, Germany, Denmark, France, the Netherlands, Ireland, Norway, Austria, Portugal, the United Kingdom, and the United States.

Regulatory Response to the Financial Crisis – EU



Since the onset of the financial crisis in 2008, many EU countries have taken action to suspend or ban short selling. However, because these were uncoordinated, it was possible to circumvent restrictions in one jurisdiction by carrying out transactions in another. They also created additional costs and difficulties for investors operating in several markets.

Therefore, in 2012 the EU adopted a [regulation](#) which

- increases transparency by requiring the flagging of short sales, so that regulators know which transactions are short
- gives national regulators powers – in exceptional circumstances, and subject to coordination by European Securities and Markets Authority (ESMA) – to temporarily restrict or ban short selling of any financial instrument
- requires central counterparties providing clearing services to ensure that there are adequate arrangements in place for buy-in of shares as well as fines for settlement failure

Transparency of net short positions (NSP)



- Notification to competent authorities: 0.2% of the issued share capital of the company concerned and each 0.1% above that
- Public disclosure: 0.5% of the issued share capital of the company concerned and each 0.1% above that
 - Concerns:
 - Reinforcing herd behavior
 - Weakening incentives of short sellers due to other investors free-riding
 - Flagging out possible targets of a short squeeze

Short Sale Bans

(long-term, not exceeding 3 months)



- In the case of adverse events which constitute a serious threat to financial stability or market confidence *if*
 - *Necessary to address the threat*
 - *No detrimental effect on efficiency which is disproportionate to its benefits*

Short Sale Bans

(short-term, one trading day, should not exceed three consecutive days)



- If the price of a financial instrument has fallen significantly (10% or more) during a single trading day in relation to the closing price on that venue on the previous day

Short Selling Bans during COVID

Table 1: Sample Distribution by Country and Ban Status

Country	Obs. with Ban	Obs. with No Ban	% Obs. with Ban
Austria	884	1,089	44.80
Belgium	2,212	2,722	44.83
Denmark	0	5,789	0.00
Finland	0	7,687	0.00
France	11,319	14,370	44.06
Germany	0	14,583	0.00
Greece	1,310	2,347	35.82
Ireland	0	1,151	0.00
Italy	7,197	9,181	43.94
Luxembourg	0	157	0.00
Netherlands	0	4,363	0.00
Portugal	0	1,426	0.00
Spain	2,933	3,631	44.68
Sweden	0	24,546	0.00
Country	Obs. with Ban	Obs. with No Ban	% Obs. with Ban
United Kingdom	0	32,144	0.00
Total	25,855	125,186	17.12

Source:
Siciliano/Ventoruzzo, ECFR
2020, 386

„Meme Stocks“ volatility

Day traders pump up the value of a handful of stocks

Share price performance on January 27 2021 (%)



Source: Bloomberg
© FT

Source: <https://www.ft.com/content/acc1dbfe-80a4-4b63-90dd-05f27f21ceb2>

„Meme Stocks“ and Short Squeezes



Unless he is confronted with a short squeeze

Source:
<https://www.ft.com/content/47e3eaad-e087-4250-97fd-e428bac4b5e9>