

# Short Selling Stands the Test of Time, but Now Faces Disclosure Debate

Short selling has been around as long as there have been stock markets, and since the beginning, governments have tried to regulate the practice. Yet short selling's longevity is a testament to the benefits that short selling provides to stock markets. While many governments, including those in the US, UK and Australia, banned short selling in 2008, the bans have been lifted

**T**he question now is whether regulators should require investors to disclose short positions, and if so, whether those disclosures should be made public. While French regulators recently instituted a new public disclosure regime and the rest of Europe contemplates the question of short selling disclosure, regulators in Asia, most notably in Hong Kong and Japan, seem to have already made up their minds.

## **Disclosure rules of France, Europe**

France's securities regulator, the AMF, announced that starting February 1, investors who have a short position greater than .2% of a French company's outstanding shares must report their position to the AMF. Furthermore, the AMF will publish the names of investors who have short positions greater than .5% of a company's shares.

For instance, Neopost is a French company that makes mailing and postage equipment, and AKO Capital has shorted 2.81% of Neopost's outstanding shares. In addition to AKO, Eminence Capital is short 1.22%, Greenlight 1.11%, AQR 0.89%, North Run 0.69%, and Brahman 0.59%. Going forward, these funds with existing short positions must notify the AMF whenever their short position crosses any .1% threshold. Should AQR increase its short position from .89% to at least .90% of Neopost's outstand-



ing shares, it would notify the French regulator and a public disclosure would follow.

Before the AMF began requiring public disclosure on February 1, the European Commission issued a set of short selling regulation proposals which laid out the same disclosure rules that the French regulator recently instituted. European authorities eventually want the same rules in place across Europe and the new European Securities and Markets Authority will eventually lead that effort. As of now, however, regulators in different countries are choosing different paths. In the UK, for instance, the FSA only requires disclosure for short positions in shares of UK financial companies.

## **Hedge funds oppose public disclosure, but leave Asia out of the discussion**

The hedge fund community does not agree that publicly disclosing short positions is worth the many risks. A recent report conducted by Oliver Wyman at the request of the Alternative Investment Management Association and Deutsche Bank found that liquidity decreased and bid-ask spreads increased as a result of previous short selling regulatory measures. The report also asserted that short selling disclosure risks are pushing investment capital out of Europe and toward areas of the world that have more balanced regulatory regimes, such as Hong Kong.

It is clear through numerous studies

that short sellers add value to the market. Because short selling is inherently riskier than long buying and selling, short sellers should not have to worry about regulators increasing the chance that short positions will be caught in a squeeze. Sizeable short interest is often viewed as a bullish indicator, and if rival hedge funds were able to push a stock's share price up to a point where a short seller could not maintain its position any longer, an unnecessary short squeeze could result.

On the other hand, the Oliver Wyman report only points to the negative effects in Europe "as a result of disclosure proposals" by the European Commission rather than what has actually happened with short selling public disclosure in Japan over the last year. In order to refute what is happening in Europe, it would be more relevant to show whether the short selling disclosure regime in Japan is negatively affecting the market there.

### Public disclosure of short positions in Japan

Public disclosure of short positions on a daily basis is not a new phenomenon. For over a year, Japan's securities regulator has required public disclosure of hedge funds' short positions. The data is published daily, on a two-

day lag, on the websites of Japan's stock exchanges. Indeed, the disclosures in Japan go further than those in France because the Japanese data is grouped by hedge fund, rather than published in separate documents for each hedge fund and individual stock short position.

For instance, in the table below, one can see Bridgewater's short positions in Japanese equities over the first several days in February 2011. Since data is released on a two-day lag, Bridgewater's short positions on January 28 were released publicly on February 1.

### Hong Kong takes different tack

Instead of following the US' lead and banning short selling in 2008, Hong Kong's securities regulator, the SFC, courageously continued to allow the practice. The SFC and its CEO, Mr. Martin Wheatley, received widespread praise for their handling of short selling regulation during the crisis.

Therefore, it seems that the work done by Mr. Wheatley as chairman of the International Organization of Securities Commissions' (IOSCO) global committee on short selling should be used to greater effect. For instance, the authors of the IOSCO consultation report on short selling, published in March 2009, note that public disclosure is not necessar-

ily positive. There are risks of excessive transparency and the price-correcting benefit of short selling may be reduced as a result.

The IOSCO report sets out four principles to effective short selling regulation, leaving out public disclosure as a necessary factor. The four principles are: 1) sellers (short or long) should not fail to deliver, 2) investors should report short positions to regulators (and regulators need to decide whether to publish), 3) regulators should trust but verify what investors are reporting, and 4) there should be an exception to the rule, namely for market makers.

Mr. Wheatley is stepping down from his post at the SFC this summer to lead the formation of a new Consumer Protection and Markets Authority in the UK, but with luck, securities regulators will continue to use the IOSCO report to construct a balanced short selling disclosure regime.

### Long buyers may also need to disclose daily

While regulators think about their response to short selling, they need to be similarly concerned about fair disclosure for long buyers as well. For instance, Moët Hennessy Louis Vuitton (LVMH) quietly acquired a 14% stake in Hermes without any disclosure. LVMH purchased cash-settled options and then later converted the options to shares. LVMH, a long buyer, essentially cornered the market on Hermes' shares.

Short sellers can be unfairly crushed by such behavior. When Porsche announced to the market in October 2008 that it held, via options, an additional 32% of Volkswagen's shares, Porsche's stake in VW increased suddenly from 43% to 75%. This caused one of the worst short squeezes in history.

The new regulations in France require that derivatives (such as contracts for difference) be included in funds' net short positions. But if regulators are going to require daily public reporting of short positions, they should think about asking the same from mutual funds on the long side as well. If the long side of the market refuses to cooperate, then maybe the disclosures regarding short positions are unfair and need to be reconsidered. ■

**BRIDGEWATER'S SHORT POSITIONS OF JAPANESE EQUITIES (EXPRESSED AS A PERCENTAGE OF OUTSTANDING SHARES)**

	QuickID	28-Jan	31-Jan	1-Feb	2-Feb	3-Feb	4-Feb	7-Feb	8-Feb
Mitsubishi Logistics	9301	.25%	.24						
Toyo Suisan Kaisha	2875	.32		.28		.25	.25		.29
Tokuyama	4043	.40							
Nissan Chemical	4021	.24							
Gunze	3002	.26							.28
Mitsumi Electric	6767	.72		.74	.26	.27			
Advantest	6857		.27	.31		.31	.28	.27	
Koito Manufacturing	7276			.29					
Aeon Credit	8570			.29				.27	
Nippon Express	9062			.28	.26	.25			
Taiyo Yuden	6976				.29	.26	.21		
Nippon Suisan	1332				.34	.32			.30
Point Inc	2685				.43	.41	.39	.38	
Chiyoda	6366				.32	.31	.28	.27	.25
Hitachi Kokusai	6756				.26	.28	.30	.31	.31
Shinko Electric	6967				.67	.64	.59		
Calsonic Kansei	7248				.39	.29	.41		.42
Obayashi	1802				.29	.27	.24		
Citizen Holdings	7762				.25				.24
Mitsui Engineer	7003				.30	.29	.27		.28
Ibiden	4062					.26	.23		
Hino Motors	7205					.25			
Japan Petroleum	1662					.42		.42	.42
Yokohama Rubber	5101						.28	.29	.31
Shimadzu Corp	7701						.27		
Ube Industries	4208						.32		.29

Source: Tokyo Stock Exchange - <http://www.tse.or.jp/english/market/report/index.html>