

Corpsec Hotline

March 23, 2007

SHORT SELLING BY INSTITUTIONAL INVESTORS...SOON TO BE A REALITY

Short selling - the sale of security that the seller does not own - is a subject matter of longstanding debate across the global capital markets. After a series of studies, discussions and debates, Securities and Exchange Board of India ("SEBI") has, yesterday at its board meeting, finally decided to take the plunge by deciding to allow institutional investors like foreign institutional investors ("FIIs") and mutual funds to participate in short-selling of securities in spot or cash market. At present institutional investors are permitted to take short position only in derivative market.

The new proposal seeks to remove the existing prohibition, which is incorporated in the SEBI regulations applicable to the FIIs and mutual funds, preventing them from engaging in short selling of stock in spot or cash market. Thus at present an institutional investor cannot sell shares unless it actually owns them. Allowing of short selling by institutional investors will enable them to borrow shares from an approved intermediary, sell it in the cash market and then buy it back from the cash market.

It is pertinent to note that, the retail investors are not subject to any such restriction and they are free to engage in short selling in both cash and derivative markets. The present move of SEBI will bring the institutional investors at par with the retail investors in this arena.

SEBI had already put in to place securities borrowing and lending mechanism way back in 1997 by way of enacting Securities Lending Scheme, 1997 ("Scheme"). The Scheme has not taken off and is almost inoperative predominantly because the SEBI regulations permit institutions like mutual funds and FIIs only to lend securities in accordance with the Scheme without any corresponding provision allowing them to borrow securities understandably because these institutional investors were not allowed to engage in short selling of stocks.

For the proposal to become a reality appropriate changes to the Scheme and relevant SEBI regulations will have to be introduced at the same time bearing in mind to keep associated costs low. However, in order for the new proposal to operate effectively, there is a need for vibrant securities lending and borrowing mechanism, which presently is lacking.

Under the new proposal it will have to be seen as to how long the institutional investors will be able to carry forward their short positions in the cash market. It also will be interesting to see if short selling will be permitted in all securities, or only in select stocks like in the case of derivatives trading. If short selling is permitted with out any restriction, it will enable the institutional investors to engage in short selling in stocks, which are not included in the derivatives trading list.

Experience of developed countries suggests that, short selling has played a significant role in controlling volatility of their capital markets and has been a catalyst in improving liquidity and depth of the capital markets. The decision to allow institutional investors to short sell, will no doubt receive a warm welcome from the institutional investors, but is also a bold and positive move by SEBI, and is a definite watershed in the evolution of Indian capital market.

Sources: [The Economic Times, March 23, 2007](#)

- [Suneet Barve](#) & [Shiju P.V.](#)

You can direct your queries or comments to the authors

DISCLAIMER

The contents of this hotline should not be construed as legal opinion. View detailed disclaimer.

This Hotline provides general information existing at the time of preparation. The Hotline is intended as a news update and Nishith Desai Associates neither assumes nor accepts any responsibility for any loss arising to any person acting or refraining from acting as a result of any material contained in this Hotline. It is recommended that professional advice be taken based on the specific facts and circumstances. This Hotline does not substitute the need to refer to the original pronouncements.

This is not a Spam mail. You have received this mail because you have either requested for it or someone must have suggested your name. Since India has no anti-spamming law, we refer to the US directive, which states that a mail cannot be considered Spam if it contains the sender's contact information, which this mail does. In case this mail doesn't concern you, please unsubscribe from mailing list.

Research Papers

FAQs on Setting Up of Offices in India

December 13, 2024

FAQs on Downstream Investment

December 13, 2024

Gaming Law 2024

December 12, 2024

Research Articles

The Revolution Realized: Bitcoin's Triumph

December 05, 2024

The Bitcoin Effect

November 14, 2024

Acquirers Beware: Indian Merger Control Regime Revamped!

September 15, 2024

Audio

Securities Market Regulator's Continued Quest Against "Unfiltered" Financial Advice

December 18, 2024

Digital Lending - Part 1 - What's New with NBFC P2Ps

November 19, 2024

Renewable Roadmap: Budget 2024 and Beyond - Part I

August 26, 2024

NDA Connect

Connect with us at events, conferences and seminars.

NDA Hotline

[Click here to view Hotline archives.](#)

Video

"Investment return is not enough" Nishith Desai with Nikunj Dalmia (ET Now) at FI18 event in Riyadh

October 31, 2024

Analysing SEBI's Consultation Paper on Simplification of registration for FPIs

Scope of judicial interference and inquiry in an application for appointment of arbitrator under the (Indian) Arbitration and Conciliation Act, 1996

September 22, 2024