

Corpsec Hotline

November 18, 2008

SHORT SELLING: WAS THE REGULATOR'S APPREHENSION MIS-FOUNDED?

Short selling (sale of a security that the seller does not own) is one of the long-standing market practices, which has often been the subject of considerable debate and divergent views in most of the securities market across the world. The votaries of short selling consider it as a desirable and an essential feature of a securities market. The critics of short selling on the other hand are convinced that short selling, directly or indirectly, poses potential risks and can easily destabilize the market.

Even recently, short selling practice was accused to be the main culprit behind the sharp falls across global stock markets, as a result of which many countries, specially US, have temporarily banned the practice in respect to certain stocks relating to financial sector companies.

The Indian regulators were not far behind with the Securities and Exchange Board of India ("SEBI") imposing a fictional curb by disapproving of overseas short selling by foreign institutional investors ("FI") in pursuance of offshore derivative instruments ("ODI") issued by them (please refer to our hotlines [SEBI disclosure on overseas securities lending: Falling 'short'? dated October 16, 2008](#) and [P Notes- Almost Full Circle dated October 8, 2008](#)), which they apparently thought was the reason behind the steep fall of Indian stock markets. However, a newspaper report in [The Economic Times dated November 15, 2008](#) suggests that there is no link between ODI induced short-sales overseas and the market fall in India. As per the report, a senior official in the Finance Ministry (name was undisclosed) stated that only 0.2% of the total 10,000 crore shares in 224 companies (19.2 crore shares) were lent by them abroad till October 9, 2008; besides, price movements in 10 biggest price losers in the domestic market had no relation with the overseas lending activity in their scrips. The official further affirmed that in ninety percent of the cases where prices fell steeply, at most only about 0.01-0.02 % shares were lent offshore and also avowed that the non-promoter holding in the 10 firms which saw the largest fall in prices was just 0.58% of their total paid-up capital.

A conspectus of the factual matrix of the above suggests that the stock market crash may not be a direct result of short selling of stocks overseas in pursuance of ODIs issued by FIIs. It may have been a measure that SEBI imposed in a hurry to prevent the percolation of the financial crises into Indian market despite of the fact that short selling may have had no role to play in the stock market crash in India.

However, SEBI still believes that ODI induced short-sales overseas was the main reason behind the recent stock market collapse in India. An article in [Indiaonline.com dated November 18, 2008](#) provides that SEBI has announced that it would come up with new rules for stock lending and borrowing by next month. The article provided that this move by SEBI is aimed to curtail ODI induced short-sales overseas and to monitor the lending and borrowing by overseas investor.

Keeping in view the above analysis and the current crunch in the inflow of the foreign currency, we believe that SEBI must relax its stand on the short selling of stocks overseas as it may enhance the liquidity in the domestic market. While international securities market regulators have recognized that short selling can exacerbate market falls and lead to manipulative activities, most of the jurisdictions have also recognized short selling as a legitimate investment activity that has contributed significantly to market liquidity. Thus, this relaxation may be done sparingly and with utmost care and caution, as the same if misused in current market conditions, could translate into an unprecedented financial turmoil.

- **Vedant Shukla & Divaspati Singh**
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

This is not a Spam mail. You have received this mail because you have either requested for it or someone must have suggested your

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 FI8 event in Riyadh

October 31, 2024

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

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.

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.

September 26, 2024

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

September 22, 2024
