

< [News](#)

The World Federation of Exchanges warns against short-selling bans

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London, Monday 30 March 2020 – The World Federation of Exchanges (“WFE”), the global industry group for exchanges and CCPs, has today issued a statement, criticising recent bans on short-selling as damaging to markets and failing to achieve their desired effect. **WFE CEO Nandini Sukumar** said:

“Banning short-selling interferes with price formation, thereby increasing uncertainty. That can only artificially amplify volatility and probability of default, the opposite effect to that claimed, and hampers the ability of markets to serve the real economy. It is not – and never has been – true that bans have any other, positive effect on market activity or price levels.”

Unlike circuit breakers and other safeguards put in place by exchanges to slow markets down in times of stress, short-selling bans inhibit orderly markets rather than promote them. Circuit breakers allow

participants time to assimilate information, with the effect of making trade-execution decisions more informed. Short-selling bans, by contrast, prevent market participants trading as effectively as possible, thereby making price information less accurate. They consequently undermine the crucial and valuable role that exchanges play in establishing the definitive, authoritative price for financial instruments at any given time.

Recent statements from global authorities point to the difficult environment in which to price securities and derivatives as making it more important to keep markets open – not less. The International Organization of Securities Commissions (IOSCO) highlighted the importance of keeping markets “*functional throughout this difficult period*”, and on 17 March 2020, the UK Financial Conduct Authority said:

“Our focus is on maintaining open markets that operate with integrity and we note that an ability to short sell can contribute to this, including by supporting effective price formation, enhancing liquidity and enabling risk management.”

Authorities may feel pressure to be seen to act decisively in the face of falling asset prices. Indeed, some short selling bans have been recently introduced. However, while the European Systemic Risk Board found that “bans on short sales tend to be correlated with higher probability of default, greater return volatility and steeper stock price declines” (see [here](#)), also the academic literature consistently shows that short-selling restrictions fail to meet their policy objective (see, for example: “Short selling bans around the world: Evidence from the 2007-09 Crisis”, by A. Beber and M. Pagano, 2013), merely giving the impression of decisive action without achieving any useful outcome.

Falling prices indicate that companies are expected to be less profitable in the future. But even in a declining market, short-selling is only a small part of market activity, notably compared with sales of existing long positions. Short-selling bans risk reinforcing the false notion that the revaluation of prices reflects a deficiency in the market – rather than a change in the value of the asset. We support instead market transparency and, in this regard, recognise the regime ESMA has put in place to report and publish net short positions in securities exceeding 1% of the free floated shares.

Investor protection is a topic that exchanges take very seriously: by providing the definitive, authoritative price at any given time; by requiring thorough disclosures and the fair dissemination of market-sensitive information; by policing against market manipulation and abuse; and, by ensuring the integrity of the trading, clearing and settlement cycle. So long as exchanges, as front-line quasi-regulatory or self-regulatory entities, determine their markets to be fair and orderly, these financial markets should operate as normal, which includes allowing short selling to continue as usual. Investor protection does not imply protection from asset prices movements based on the consensus of the market in which those investors themselves are participants.

The WFE has launched a depository of Covid-19-related public communications from exchanges and CCPs as a resource for the financial community and our stakeholders. Click [here](#) to access the webpage. If

you are an exchange or CCP, please keep the WFE informed about new initiatives and actions you are taking in regard to Covid-19, so the WFE can keep the website updated. You can do this by sending your updates to wfecovid19@world-exchanges.org

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