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Regulators Around the World Address Short Selling in Response to the COVID-19 Market Crisis

In the past month, in addition to its human impact, fallout from the COVID-19 pandemic and the oil shock have wreaked havoc on the global economy and financial markets; the S&P 500 is on track for its worst month since 1987, market-wide circuit breakers have been triggered twice in three days, volatility has spiked, and markets that are normally deep and liquid have come close to total seizure.

These developments are not remotely the consequence of short selling run amok without proper regulatory supervision. However, current conditions highlight long-term failures in securities regulatory regimes around the world to properly address short selling, and financial regulators around the world have reacted with decisive curbs on short selling: South Korea, France, Italy, Belgium, Spain, Greece and other countries have all banned short selling for periods ranging from one to six months. More important, from the perspective of long-term regulatory reform, the European Securities and Markets Authority (ESMA) has not only sanctioned these regulatory actions in Europe, but also lowered the disclosure threshold for short positions to 0.1% of a company's net share capital. The ESMA wrote that:

> *lowering the reporting threshold is a precautionary action that … is essential for authorities to monitor developments in markets. The measure can support more stringent action if required to ensure the orderly functioning of EU markets, financial stability and investor protection.*

Whether 0.1% is the appropriate disclosure threshold for peacetime is a matter that can be debated once the world emerges from the current pandemic. But it is quite clear that market regulation has for a long time not struck the proper balance in regulating short selling and related practices. We have long noted the dangers of manipulative and abusive short selling and the need for enhanced regulation and disclosure. During the 2008 financial crisis and the recession that followed it, we called on the U.S. SEC to reinstate the "Uptick Rule," as a check on market abuses (see our memos of July 2008, November 2008 and January 2009). We have written more recently on calls for regulatory reform in the United States and France, and have in the past called for and reported on proposed changes to the U.S. disclosure requirements with respect to securities ownership and the regulation of short trading. Leading corporate governance organizations and the major U.S. exchanges (the NYSE in 2013 and 2015 and Nasdaq in 2015) have also petitioned for rulemaking to improve market transparency and accountability.

Even in stable markets, the lack of a coherent regulatory framework regarding short selling – including particularly the dangers posed by secret share accumulations and dispositions, and lack of accountability for market-moving propaganda attacks – poses risks to companies, investors and the capital markets more generally. In the midst of the turmoil currently gripping U.S. and global markets, the need for regulatory action is more urgent than ever.

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