

Portfolio Strategy

Impact of Short Selling Bans in Europe

Market Commentary

19 October 2011

Key Points

- Effective August 12th regulators in Belgium, France, Italy and Spain introduced short selling bans on financial stocks.
- The bans appear to have done little to halt the slide in share prices or dampen volatility relative to peers.
- They may also have contributed to significantly reduced liquidity in affected financials and a widening of bid-ask spreads, increasing the cost of trading.
- These effects may partly explain why other major European countries have thus far failed to follow suit.

Short Selling Bans Return to Europe

Belgium, France, Italy and Spain Introduce Bans in Response to Euro Debt Crisis Volatility

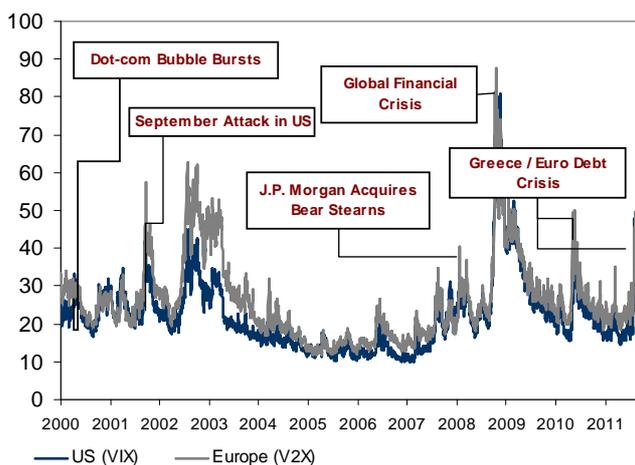
On August 11th regulators in Belgium, France, Italy and Spain introduced short selling bans on financial stocks¹ following a period of high volatility linked to the euro debt crisis. The bans – which according to ESMA were introduced in order to “restrict the benefits that can be achieved by spreading false rumours”² – became effective on August 12th. With the exception of Belgium, they were originally intended to last 15 days only, but these dates have since been extended (see Exhibit 1).

Exhibit 1: Ban Summary

Country	Proposed End Date	No. of Stocks
Belgium	Indefinite.	4
France	Until further notice and for a period that cannot go beyond November 11th.	9
Italy	November 11th.	28
Spain	Indefinite	13

Source: Credit Suisse Portfolio Strategy

Exhibit 2: A Decade of Volatility



Source: Credit Suisse Portfolio Strategy, Jan 3, 2000 to Sept 2, 2011

Déjà vu All Over Again?

This is not the first time regulators in Europe have banned short selling in response to a spike in volatility. For example, in May 2010 Germany introduced a temporary ban on naked short selling of financials; and, in September 2008 – at the height of the global financial crisis – the UK temporarily banned short selling in financials, and was quickly followed by other major European countries and the US.

Our analysis of these bans – for example [Short selling - What's going on in Europe?](#) and [Examining the Wake of the Short Sale Restriction](#) – suggests that not only do short selling bans not stop share price declines, they also tend to result in reduced liquidity and wider bid-ask spreads, increasing the cost of trading.

In this report we again focus mainly on performance, liquidity and bid-ask spreads, using non-financials in the affected countries as well as non-banned financials in Germany, the Netherlands and the UK for our control groups. Our findings may explain why other major European countries have thus far failed to follow suit.

¹ For further information on short selling regulations please see www.esma.europa.eu/data/document/2011_39.pdf.

² “ESMA promotes harmonized regulatory action on short selling in the EU”. European Securities and Markets Authority. 11 August 2011.

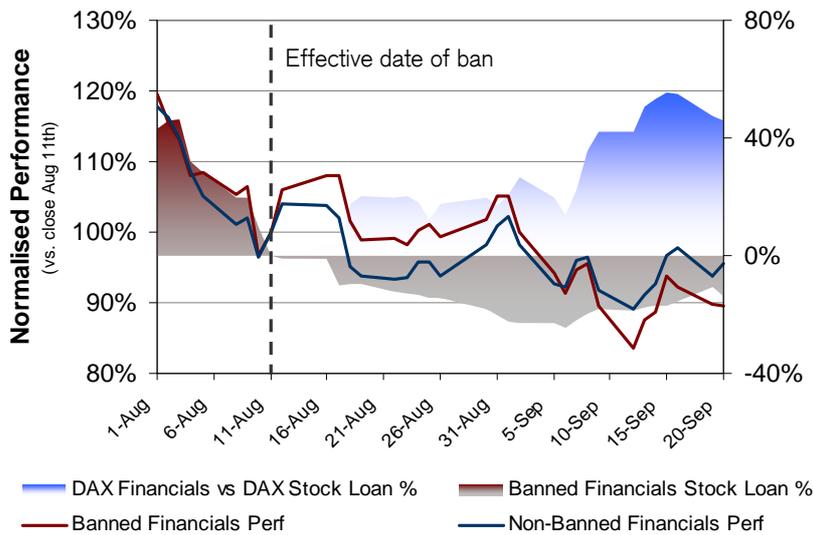
Banned Financials Underperform Non-banned Financials

Selling Pressure Comes from Long Sellers

As shown in Exhibit 3, the short selling ban appears to have done little to halt the slide in share prices. Following an initial period of outperformance when short sellers reduced their positions, banned financials are now 10.4% lower than when the ban was introduced versus a 4.4% decline in non-banned financials. This is despite a significant shift in the amount of stock on loan – a proxy for short interest – away from banned names towards non-banned German financials, and implies that *long* sellers (as opposed to speculative short sellers) are forcing prices down.

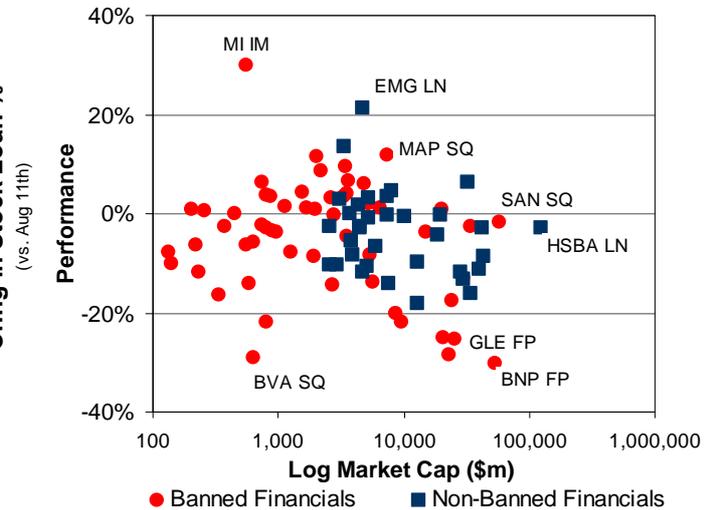
This point is reinforced in Exhibit 4 which shows that since the ban was introduced most of the biggest fallers have been banned stocks.

Exhibit 3: Performance of Banned / Non-Banned Financial vs. % Change in Short Interest of Banned / DAX Financials



Source: Credit Suisse Portfolio Strategy, Aug 1, 2011 to Sept 20, 2011

Exhibit 4: Performance of Banned vs. Non-Banned Financials Post Ban*



Source: Credit Suisse Portfolio Strategy, Aug 12, 2011 to Sept 20, 2011
 * Caja De Ahorros Del Medi (CAM SQ), a banned stock which has fallen ~60% since the ban was introduced is excluded from this chart.

Exhibit 5: Turnover (Volume) in Banned Financials vs. Control Groups

Time Period	Banned Financials	Non-Banned Financials	Non-banned (Belgium, France, Italy, Spain)
Median Turnover (Volume) for Ban Period vs. Median Turnover (Volume) from Jan 3rd - Aug 11th	-43% (-34%)	-22% (+26%)	-1% (+1%)

Source: Credit Suisse Portfolio Strategy, Jan 3, 2011 to Sept 15, 2011

Liquidity Dries Up

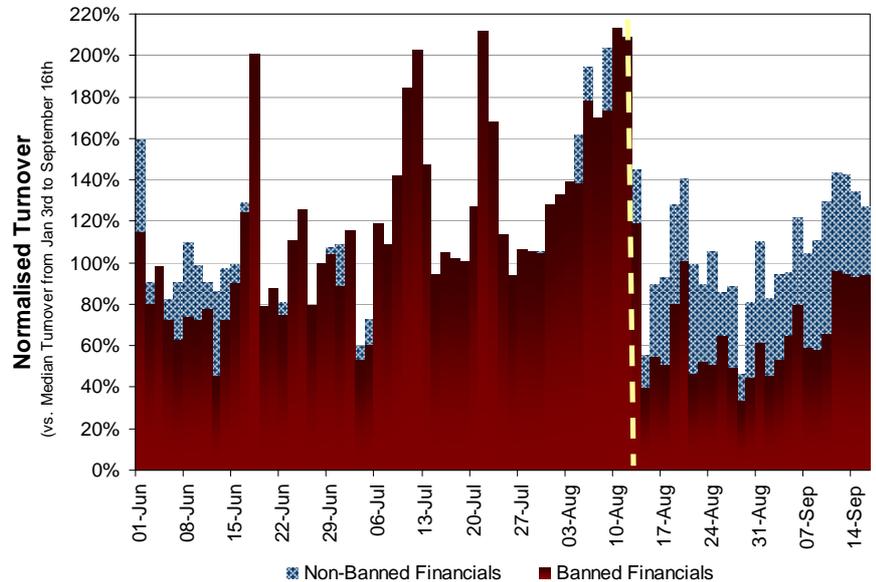
Liquidity in Banned Financials Shrinks

The ban may have contributed to reduced liquidity in banned names (see Exhibit 5). Median turnover in banned financials is 43% down versus median turnover from January 3rd to August 11th, 2011. This compares to 22% down for non-banned financials and 1% down for non-financials in the same countries. The drop in turnover is even more pronounced versus the pre-ban crisis period in August, and is only partly explained by share price declines.

Relative Liquidity of Non-Banned Financials Increases

The ban appears to have contributed to a relative increase in the liquidity of non-banned financials (see Exhibit 6), and is likely linked to traders seeking alternative hedges to long positions, as highlighted in Exhibit 3.

Exhibit 6: Turnover of Banned vs. Non-Banned Financials



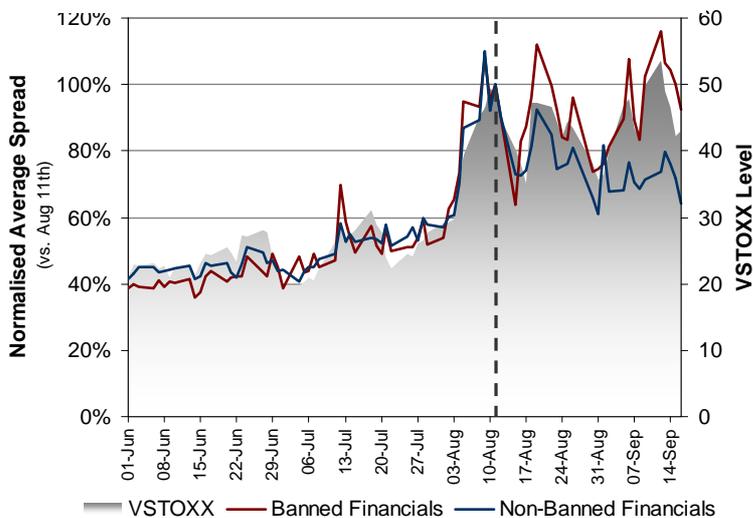
Source: Credit Suisse Portfolio Strategy, Jun 1, 2011 to Sept 15, 2011

Bid-Ask Spreads Widen

Bid-Ask Spreads Widen vs. Non-Banned

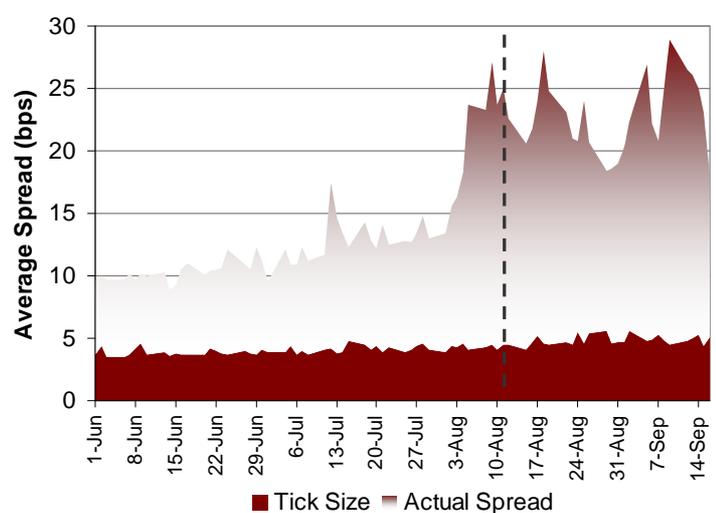
As well as reducing liquidity, the ban may also have contributed to a widening of bid-ask spreads. This is evident in Exhibit 7 which shows that average spreads in banned and non-banned financials diverge strongly at the point where the ban is introduced, but continue to track volatility well. As shown in Exhibit 8, the basis point change in average spreads for banned financials does not simply reflect the decline in share prices.

Exhibit 7: Average Spreads of Banned and Non-Banned Financials vs. Volatility



Source: Credit Suisse AES Analysis, Jun 1, 2011 to Sept 16, 2011

Exhibit 8: Tick Size vs. Actual Spread for Banned Financials



Source: Credit Suisse AES Analysis, Jun 3, 2011 to Sept 16, 2011

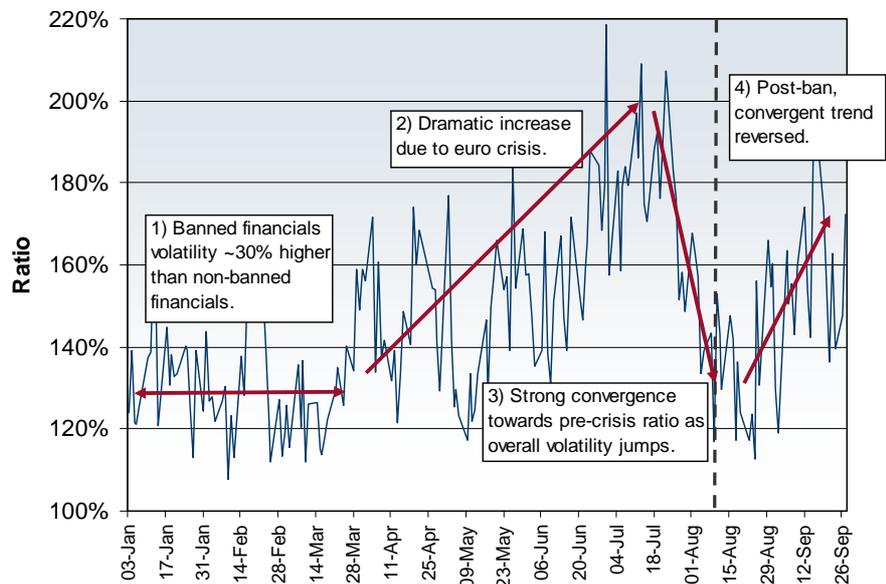
Relative Volatility Increases

Ratio of Banned vs. Non-Banned Volatility Was Falling Pre-Ban but has Risen Again Post-Ban

“Since the ban, there has been a clear change in volumes and volatility of the financial stocks, which now behave more or less in line with other stocks”³ – Thierry Francq secretary general of the AMF.

As we have seen, volumes in banned financials have dropped substantially more than non-banned financials (see Exhibit 5). As to whether the ban has reduced the volatility of banned financials versus their peers, we can see from Exhibit 9 that this is not the case.

Exhibit 9: Volatility Ratio - Banned vs. Non-Banned Financials*



Source: Credit Suisse AES Analysis, Jan 3, 2011 to Sept 27, 2011

* Volatility is calculated using 15min intra-day returns.

For most of the year, the financial stocks that would eventually be banned traded with approximately 1.3 times the volatility of their peers. While the recent Eurozone panic saw this difference increase dramatically (peaking at 2 times around mid-July), towards the end of July – as overall volatility increased – the volatilities of these financials and our control group began to converge, the ratio reaching pre-crisis levels immediately before the ban. However, following the introduction of the ban, the stocks affected have become relatively more volatile again, reversing what had been a convergent trend.

³ Hughes, Jennifer. “Short sellers remain calm despite bans” *FT.com*. The Financial Times. 23 August 2011.

Conclusion

At times of extreme volatility, it is easy to understand why regulators react by introducing short selling bans and blaming false rumours for driving prices down. However, as illustrated above, the short selling ban appears to have done little to halt the slide in share prices or dampen volatility relative to peers.

In fact, the affected financials have seen bid-ask spreads widen and have suffered a significant drop in liquidity since the ban was introduced, increasing the cost of trading.

While short selling bans represent a tempting and politically expedient option, closer inspection demonstrates that in fact they do more harm than good. Perhaps it should come as no surprise that they have not seen more widespread use.

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