Summary of the Research Project Proposal

Revealing shorts:
An examination of large short position disclosures

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Since the financial crisis of September 2008, short sellers have come under increased scrutiny from regulators and the popular press. For example, earlier this year in the U.S., the Securities and Exchange Commission asked for input on whether more short sale disclosure was warranted (release No. 34-64383). The sunlight of disclosure could discourage abusive short selling if it exists. Alternatively, disclosure could provide a coordination mechanism for short sellers, or lead to undesirable short squeezes.

The European experience should be instructive, as the UK, France, and Spain have each begun to require that short sellers publicly disclose large short positions. We have obtained data from these European short position disclosure regimes, and will analyze the effects of these disclosures on share prices and on the behavior of short sale disclosers and other market participants.

In terms of specific innovations, this research should help regulators determine the effects of requiring short position disclosure. In addition, this research should help investors assess the effects of their own short sale disclosures, and adjust portfolio strategy accordingly.
In the UK, any short seller with a short position in a stock that exceeds 0.25% of the shares outstanding is required to publicly disclose the size of the short position. Further disclosure is required if a short position changes by 0.1% or more of shares outstanding. In other words, additional disclosures would be required at 0.35% of shares outstanding, 0.45%, 0.55%, and so on. If a short position decreases below 0.25%, that must be disclosed as well. Disclosures are due the day after a threshold is reached. Thresholds in Spain and France vary, but otherwise the rules in those countries are similar.

Data Explorers has generously provided us with a database of UK and Spain short position disclosures since September 2008, which were collected from publicly available news sources. France short positions are available from the website of the AMF, the French securities market regulator. For each short position disclosure, we know the date (and often the exact time) of the disclosure, the identity of the short seller, the instrument being sold short, and the percentage of shares outstanding being sold short. Data Explorers also generously provided us their securities lending database for UK and European stocks over the same timeframe. Data Explorers collects securities lending data from securities lenders, such as custodians, who lend stock to prime brokers, and their data cover at least 80% of the equity loan transactions in the market. Based on these equity loan transactions, Data Explorers provides a qualitative measure of the fee for borrowing a particular stock on a particular day as well as the total number of shares loaned by its securities lenders. For the UK, the electronic settlement system CREST also provides data on equity loan amounts, and we also use their equity loan quantities as proxies for short interest.

We plan to investigate stock price effects associated with the disclosure of a large short position using an event study approach. We plan to use logit and duration models to see whether the disclosure of a short position is followed by more short selling and disclosures by other short sellers. The UK short position disclosure regime applies to financial stocks and stocks undergoing rights issues. Additional considerations apply to rights issues, so we plan to examine these corporate events separately.

Our preliminary results suggest that hedge funds and other short sellers are piggybacking on the information in a short position disclosure. Over the next few days, these followers appear to pile on with additional large short positions in the same stock. Interestingly, this additional shorting activity does not seem to have any stock price effects, but our initial results suggest that short position disclosures do have important knock-on effects, and these should be carefully considered by regulators, short sellers, and other investors.