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France Selectively Bans Short-Selling of 11 Banks; Spain Bans Shorting and Derivatives Based Shorting; Why the Bans Will Fail

Three days ago regulators issued a statement saying they would not ban short-selling. They repeated that statement earlier today, then reversed course.

In France, the short-selling ban includes a group of select bank and financial institutions.

Here is the **AMF News Release**.

> The Chairman of the Autorité des marchés financiers (AMF), acting in accordance with Article L. 421-16 II of the Monetary and Financial Code, has decided to place a ban on creating any net short position or increasing any existing net short position, including intraday, by any person established or residing in France or in another country, in the equity shares or securities giving access to the capital of the following credit institutions and insurance companies:
>
> - April Group
> - Axa
> - BNP Paribas
> - CIC
> - CNP Assurances
> - Crédit Agricole
> - Euler Hermès
> - Natixis
> - Paris Ré
> - Scor
> - Société Générale
>
> This decision shall enter into force as soon as it is published on this AMF website as from 22.45 today and shall remain in effect for a period of fifteen days. It may be extended beyond that date pursuant to the conditions provided in the aforementioned Article L. 421-16 II.
>
> This decision does not apply to financial intermediaries acting as market makers or liquidity providers when they are operating under a contract with the relevant market undertaking or with the issuer

concerned, or when acting as counterparty for block trades in equities.

The AMF will publish a FAQ to deal with the technical questions raised by this decision.

Spain Bans Shorting and Derivatives Based Shorting

FT Alphaville, in **Will the short-selling ban come up short?** notes the Spain ban includes artificial shorting via derivatives.

Here's the **Spanish statement** (translated using Google Translate). Note the specific references to derivatives:

....

The ban will remain for a period of 15 days from the date, may be extended if deemed necessary. The interim ban applies to any transaction in shares or indices, including cash transactions, derivatives on exchanges or OTC derivatives, which involves creating a net short position or increase a existing, albeit intraday. Short position means those that result in positive economic exposure to a drop in price action.

Excluded from the injunction prohibiting operations that are performed by entities to develop market-making functions. Means such financial institutions or investment services companies, in response orders from clients or quoting prices as a result of supply and demand continuously in their capacity as members of secondary markets official incurred temporarily, especially intraday short positions.

Spanish Ban List

- Civic Banking, SA
- Banco Bilbao Vizcaya Argentaria, SA
- Banco de Sabadell, SA
- Banco de Valencia SA
- Spanish Banco de Credito, SA
- AGREEMENT IN CONNECTION WITH THE CNMV
- SPANISH SHORT POSITIONS IN SHARES
- FINANCIAL SECTOR Banco Pastor, SA
- Spanish Banco Popular, Inc.
- Banco Santander, SA
- Bankia, SA

- Bankinter, SA
- Caixabank, SA
- Caja de Ahorros del Mediterráneo
- Grupo Catalana de Occidente SA
- Mapfre, SA
- Spanish Stock Exchanges and Markets, Inc.
- Renta 4 Investment Services, Inc.

Why the Ban Will Fail

Shorts have to cover eventually. Short covering supports the market. These attempts to drive out shorts removes that pool of buyers. Frequently, the immediate short-term reaction is for share prices to rise.

This gives a false signal that the policy worked. However, forced covering plants seeds of its own destruction by removing a pool of potential buyers in one fell swoop.

After shorts are forced out, an air pocket forms below where there are no natural buyers.

Moreover, please note this key sentence in both the French and Spanish bans: "*Excluded from the injunction prohibiting operations that are performed by entities to develop market-making functions.*"

Think about that for a second. In the short-covering rally that ensues, short positions effectively go to market-makers. If market-makers are the only ones left short, what happens to the bid after everyone else covers? Then what happens on the way back down when there are no natural buyers?

FFF - Fast Furious Failed

In the US, in September of 2008, there was a fast, furious short-covering rally of the nature I described above, after the US foolishly instituted a ban. That rally was all taken back and then some a few days later.

On September 19 2008, the **SEC Halts Short-Selling in 799 Financial Stocks**. Let's tune into a reply, looking at the Bank Index as a proxy for the 799 banned shorts.

$BKX Daily Chart Autumn 2008

click on chart for sharper image

Even if you disagree with my interpretation, there is no evidence in history that suggests short-selling bans ever work. Indeed, there is evidence they don't, and there are solid theoretical reasons why they shouldn't work.

One can disagree with my rationale, but there can be no arguments about the actual results. History shows that at best short-selling bans accomplish nothing, and at worst they increase suspicion, heighten volatility, and create air pockets that will be quickly filled.

So why do we have such bans? Answer: Because bureaucratic fools who do not have a clue about how markets work always have a sense of urgency to "do something".

So, something was done. It cannot possibly help. If by some miracle bank shares rally in a sustained fashion, it will be because they were ready to, not because of the short-selling bans.

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