Comprehensive Review of the Short Selling Regulation – An Overview (Proposed)

- Currently, the following permanent measures with respect to the short selling of listed securities are in place:
  (1) Uptick rule (in principle, prohibition of short selling at the same or lower price than the most recent price published by the exchange)
  (2) Verification and flagging requirement for short selling transactions

  In addition, the following temporary measures have been introduced:
  (1) Prohibition of naked short selling (short selling without ownership or arrangement to borrow shares at the time of sale)
  (2) Reporting and public disclosure regime for short positions equal to, or exceeding, 0.25 percent of the issued shares in principle

- Going forward, taking into account the overall regulatory trends in other markets, the following revisions to the short selling regulation have been proposed.

1. Revision to the Reporting and Public Disclosure Regime for Short Positions

(1) Changing the Status of the Reporting and Public Disclosure Regime for Short Positions

- Going forward, the reporting and public disclosure regime for short positions will no longer be a temporary measure.

(2) Changes to the threshold level for reporting and public disclosure (Introduction of the so-called 'Two Tier Model')

- Going forward, once the short position reaches 0.2 percent of the issued shares (ratio of shorted shares to the issued shares), the short position reporting requirement would be triggered.

- Once the short position reaches 0.5 percent of the issued shares, the public disclosure requirement would be triggered.

- Short position ratio would be calculated as follows.

  - To quantify the short positions, the short position held at the market close is used.
  - For issued shares, the quantity as of the day in which the reporting obligation arose is used, but if this is not known, the issued shares as detailed in the most recent annual securities report ("yuka-shoken hokokusho"), quarterly securities report ("shihanki houkokusho"), semiannual securities report ("hanki houkokusho"), or the latest commercial register, can be used as an alternative.

(3) Introduction of Amended Reporting Level

- Once the initial reporting requirement at a short position of 0.2 percent is triggered, filing of an amended report would be required at every 0.1 percent increments thereafter. When the short position ratio falls below 0.2 percent, the holder will report short position once thereafter. Similarly for public disclosure, when the short position ratio falls below 0.5 percent, public disclosure would be required once thereafter.

(4) Streamlining of the Reporting and Public Disclosure Procedures

- The existing framework requires the reporting and public disclosure of short positions arising from exchange transactions only. This requirement will be revised to include reporting and public disclosure for all short positions.

- The holder of a short position will report the short position and other related information to the exchange via the member of the exchange, and the exchange will publicly disclose such information.

- When a security that is subject to reporting and public disclosure requirement is listed on multiple exchanges, the relevant exchange member will report to the primary exchange.

(5) Expanding and Enhancing the Content of the Reporting and Public Disclosure

- The details of short position and other related information which must be reported and publicly disclosed remains the same, namely: (1) registered company name, trade name, or full name, (2) legal address or trade location, (3) securities name, (4) calculation date, (5) the level of short position expressed in either number of shares or trading units, and (6) short position ratio. However, in the case of amended reports, they must also include: (7) the calculation date and the short position ratio as stated in the previous report.

- Regarding the handling of reporting and public disclosure information, currently exchanges publicly disclose the information on an individual basis, in order to enhance investor convenience and to deter unfair trading, the FSA will be working with the exchanges to make practical improvements, for example, to enable public disclosure to be made in a tabulated format.

2. Revisions to the Uptick Rule

(1) Adoption of the Trigger Method

- Under the existing framework, the uptick rule applies at all times. Going forward, a framework whereby the uptick rule (i.e., a ban on short selling at a price equal or below the most recently published price) is applied only when the price falls below a certain threshold (10 percent fall in price relative to the previous day’s closing price), will be adopted

<u>(2) Application Period for the Uptick Rule</u>

- The rule will be in effect from when the restriction is applied, until the end of the next market day.

<u>(3) Enhanced Scope of Application</u>

- Transactions executed in the proprietary trading systems (PTS) (executed only under the auction method, customer order matching method, or market making method) will be added to the scope of the regulation.

3. Revisions to Naked Short Selling Prohibition

<u>(1) Changing the Temporary Status of the Framework</u>

- The framework for prohibition on naked short selling (short selling in which stocks are not owned or borrowed at the time of selling) were introduced as a temporary measure, however, going forward this will no longer be a temporary measure.

<u>(2) Enhanced scope of Application</u>

- Transactions executed in PTS (executed only under the auction method, customer order matching method, or market making method) will be included in the scope of naked short selling prohibition.

4. Other

<u>(1) Expanding the Scope of Short Selling Regulation Requirements Such as Verification and Flagging Requirement, and Public Offering Related Requirements</u>

- Along with the above revisions, transactions executed in PTS (only for auction method, customer order matching method, or market making method) will also be subject to short selling regulation requirements such as verification and flagging requirements, and short selling restrictions during public offering.

<u>(2) Review of the Scope of Transactions Excluded from the Regulation</u>

- Review of the scope of transactions excluded from the regulation will be made, taking into account the following perspectives, while observing the existing framework.
  (1) The expanded and enhanced application scope of the new short selling regulation
  (Example: arbitrage trades between exchange and PTS will be excluded from the regulation)
  (2) Diversification of listed instruments
  (Example: transactions currently excluded from the regulation, such as hedge selling relating to ETF exchanges and purchases, that are only allowed for certain ETFs, will be expanded to all ETF)
  (3) Transactions with the possible aim of evading the regulation
  (Example: transactions which in reality is a customer order for short selling that would have been subject to regulation falsely appear as an actual sale in the security firm’s house account, will be captured)

5. Implementation Period

- Taking into considering the preparation required by relevant market participants, the FSA will implement the above revisions by around November this year. In the meantime, temporary measures that are due to expire at the end of April will be extended until the above revisions have been implemented.