



Short selling laws in securities markets of selected countries and recommendations for Vietnam

Giang Ly Huynh, Nguyen Trung Nghia, Tang Xuan Hai

Department of Economic Law, Hanoi Law University, Hanoi, Vietnam

Abstract

Short selling is a crucial financial instrument widely utilized in developed stock markets such as the United States, Singapore, and the European Union to enhance market liquidity and enable investors to hedge risks against declining stock prices. These jurisdictions have established stringent regulatory frameworks to govern short-selling activities, ensuring market transparency and stability.

In Vietnam, the Law on Securities 2019 and its accompanying regulations have laid the legal foundation for regulated short-selling transactions. However, the absence of detailed regulatory guidelines has resulted in a legal gap, diminishing market attractiveness and exposing investors to uncertainties and risks. Currently, investors can only conduct short-selling transactions in the derivatives market through VN30 index futures contracts, while no supporting mechanism exists for the equities market. Therefore, analyzing short-selling regulations in the U.S. and Singapore will provide a comprehensive perspective, clarify Vietnam's regulatory landscape, and propose practical solutions to strengthen its legal framework. Establishing a clear and effective regulatory mechanism will not only enhance trading flexibility but also expand opportunities to attract foreign investment, improve market competitiveness, and lay a solid foundation for the sustainable development of Vietnam's stock market in the context of global financial integration.

Keywords: Short selling, short selling transactions, naked short selling, covered short selling, risk hedging strategies

Introduction

Historically, short selling first emerged in the 17th century in the Dutch Republic, with merchant Isaac Le Maire being the first individual to engage in this practice. Since then, short selling has become a widely used instrument in global stock markets and has been subject to regulation by numerous legal systems to balance investment interests and market stability.

Short selling is an investment strategy that allows investors to profit from the decline in the price of securities by borrowing and selling securities at a high price and subsequently repurchasing them at a lower price to return to the lender. This activity plays a crucial role in enhancing market liquidity and supporting price discovery, but it also carries inherent risks and the potential for market manipulation.

The following study focuses on analyzing the regulatory framework governing short selling in Vietnam, comparing it with the legal systems of the United States and Singapore, and proposing recommendations for improvement to attract investors and facilitate the market upgrading process.

1. Legal Regulations on Types of Securities Eligible for Short Selling and Sanctions for Violations under Singapore Law

In Singapore, short selling is legally permitted but is subject to strict regulation by the Monetary Authority of Singapore (MAS) and the Singapore Exchange (SGX). According to MAS's *Guidelines on Short Selling Regulations*, short selling refers to the sale of capital market products that the seller does not own at the time of the sale. The types of securities eligible for short selling are specified under Chapter 289 of the Securities and Futures Act (SFA), including: equities (both common shares and preferred shares) listed on SGX, business trusts, real estate investment trusts (REITs), and derivative products such as options and

warrants, provided that these products meet specific criteria to qualify as short sale transactions or short positions.

The first capital market product to be mentioned is shares. In this context, shares refer to any equity securities of a company listed on an approved exchange (listed on SGX). Shares include both common shares and preferred shares. The Monetary Authority of Singapore (MAS) specifies that secondary-listed shares on SGX are also included^[1].

The second product is the Business Trust—a legal structure that can be used to delegate the management of the beneficiaries ownership interests in a particular business. It can also be utilized to operate the business itself^[2]. The eligible business trusts in this case refer to any units in a business trust listed on an approved exchange (listed on SGX).

The third product is the Real Estate Investment Trust (REIT). REITs are companies that own, operate, or finance income-generating real estate across a range of property sectors. These investments allow investors to earn income from real estate without having to buy, manage, or finance the properties directly^[3].

Finally, derivative products (such as options and warrants) are also considered. In Singapore, these products are currently excluded from the definition of short sale orders or short positions. However, once they are exercised and obligations arise to make or take actual delivery of the specified capital market products, they will be included in the determination of short sale orders or short positions from that point onward^[4].

Regarding enforcement measures, Singapore implements strict penalties under the Securities and Futures Act (SFA) 2001 for offenses such as fraud, market manipulation, and failure to report short positions. Specifically, individuals may face fines of up to SGD 250,000, imprisonment for up to 7 years, or both, while corporate entities may be fined up to SGD 500,000. Additionally, administrative penalties

include fines of SGD 50,000 for individuals and SGD 100,000 for corporations, or three times the amount of the unlawful gains, whichever is higher.

To ensure deterrence, SGX reserves the right to suspend trading, revoke licenses, or impose additional sanctions on entities involved in severe violations, particularly in cases of naked short selling that pose systemic risks to the market. In large-scale market manipulation cases, penalties may include unlimited fines, depending on the extent of damage caused, and permanent bans from participating in trading activities on SGX.

2. Legal regulations on the types of securities eligible for short selling and the penalties for violations under U.S. law.

In the United States, only certain types of securities are permitted for short selling, primarily listed stocks, marginable securities, and highly liquid exchange-traded funds (ETFs). Low-liquidity, small-cap, or unlisted stocks may be restricted or prohibited from short selling. Regulations on short-sellable securities are established to ensure market transparency and stability.

According to current legal regulations, securities allowed for short selling in the U.S. include the following:

First, listed stocks^[5]: Stocks listed on major U.S. exchanges such as NYSE (New York Stock Exchange), Nasdaq, and AMEX are generally permitted for short selling if they meet margin requirements. These exchanges maintain a list of shortable stocks, called the "Easy-to-Borrow List" (ETB List), which is updated daily by brokerage firms.

Second, marginable securities: Under Regulation T of the Federal Reserve, only securities that qualify for margin trading can be shorted. This means the security must have high liquidity and sufficient market capitalization to mitigate the risk of price manipulation.

Third, exchange-traded funds: Highly liquid exchange-traded funds (ETFs) are generally allowed for short selling^[6]. Examples include SPDR S&P 500 ETF (SPY), Invesco QQQ Trust (QQQ), and iShares Russell 2000 ETF (IWM)^[7]. Some ETFs are structured similarly to short positions, meaning that investors buy the fund to take a position against a security, commodity, or index. These are called inverse ETFs. To short an ETF, investors typically need a margin account with a brokerage firm, which allows them to borrow funds for trading securities or executing short sales. They must also maintain sufficient funds to cover potential losses from short selling and meet all margin requirements set by the brokerage^[8].

Fourth, bonds^[9]: Because bonds, like any other securities, experience market fluctuations, traders may seek to profit by betting that bond prices will fall. They can short bonds, but this is typically more challenging than shorting stocks. Short selling bonds works similarly to shorting stocks, as investors sell bonds they do not own and must borrow them. This requires a margin account and collateral for the borrowed amount. Additionally, there are interest costs associated with borrowing. Just as a stock short seller must pay any dividends to the lender, a bond short seller must pay the lender any interest owed on the bonds^[10].

Securities restricted from short selling: Some types of securities are restricted or prohibited from short selling to protect the market and investors. (a) Securities on the Hard-to-Borrow List: If a stock is not on the "Easy-to-Borrow" list and falls under the "Hard-to-Borrow" category, investors

may have difficulty shorting it or be prohibited from doing so due to a lack of borrowable shares. (b) Small-cap and low-liquidity stocks: Stocks with small market capitalization and low liquidity may be restricted from short selling due to their susceptibility to price manipulation and volatility. (c) Temporarily banned short-sell stocks: In certain cases, the SEC may impose temporary short-selling bans on specific stocks, particularly during financial crises. (d) Unlisted stocks: Stocks traded over-the-counter (OTC) or on non-exchange platforms such as Pink Sheets and OTC Markets are generally not permitted for short selling due to their high-risk nature.

Particularly, Regulation SHO, outlined in Rule 204T, requires brokerage firms to ensure that all short sale transactions are settled within three business days (T+3). If a short seller fails to deliver the securities, brokers may face penalties or be required to repurchase the securities to close the transaction^[11]. During financial crises, the SEC may temporarily enforce short-selling bans on specific securities to prevent price manipulation and maintain market stability^[12].

Violations and penalties related to short selling are governed by the Securities Exchange Act of 1934. Illegal short selling practices include naked short selling, market manipulation through short selling, and fraudulent short-selling activities. Investors engaging in such violations may face administrative penalties or even criminal prosecution. According to Section 10A and Section 21(d)(1) of the Securities Exchange Act of 1934, individuals found guilty may be subject to a short-selling ban, monetary fines, and lawsuits from affected individuals or organizations, which may include compensation for damages and legal fees^[13]. Additionally, for severe violations, under Section 32(a)(1) of the Act, individuals may face fines of up to \$5,000,000, organizations up to \$25,000,000, and imprisonment for up to 20 years, or both.

3. Legal Regulations on Types of Securities Eligible for Short Selling and Sanctions for Violations under Vietnamese Law

Under current regulations, Vietnam allows investors to conduct short selling for certain types of securities on the stock market. Specifically, Clause 3, Article 11 of Circular 120/2020/TT-BTC stipulates that the securities eligible for covered short selling include stocks and fund certificates.

These two types of securities must meet specific conditions to be eligible for short selling. According to Clause 3, Article 11 of Circular 120/2020/TT-BTC, stocks and fund certificates must be listed or registered for trading on the stock exchange. Additionally, the issuing organization of the securities eligible for short selling must meet several criteria, including: (i) the listing and trading registration period; (ii) capital scale and business performance of the issuing organization; (iii) liquidity and price fluctuation (if applicable); (iv) information transparency; and (v) other criteria as guided by the State Securities Commission (SSC). To short sell stocks and fund certificates, investors must have a margin account with cash or equity in that account as collateral. Investors must maintain sufficient equity in their accounts as collateral for margin loans (at least 30% according to the regulations of each securities company)^[14] to sustain their short positions (holding borrowed stocks). Investors are also required to pay interest on borrowed stocks and ensure compliance with margin requirements throughout the holding period^[15].

Additionally, the Vietnam Exchange (VNX) publishes a list of securities eligible for covered short selling and securities that are prohibited from covered short selling based on criteria set by the SSC^[16]. Therefore, securities available for lending in short selling must both meet regulatory requirements and be included in the VNX-approved short selling list.

In the derivatives market, under Articles 3 and 4 of Circular 58/2021/TT-BTC, the financial instruments eligible for short selling include stock index futures and government bond futures. The underlying asset of stock index futures is a stock index designed by VNX based on index construction and management principles issued by VNX, after reporting to and receiving approval from the SSC. For government bond futures, the underlying asset may be either actively traded government bonds or hypothetical bonds with fundamental characteristics of government bonds.

In reality, investors in Vietnam can only short sell one type of security in the derivatives market: VN30 Index Futures. Short selling in the derivatives market relies on the market's trading mechanism, where investors can open short positions without owning the underlying asset. This means investors can sell VN30 Index Futures without owning the underlying stocks, as long as they have sufficient margin funds^[17].

Overall, due to regulatory restrictions and market development limitations, direct short selling methods (selling stocks and fund certificates directly on the stock exchange) are still uncommon in Vietnam and are mainly limited to derivative instruments such as stock index futures. Some believe that direct short selling in the stock market is not yet permitted to minimize risks and maintain market stability^[18]. Furthermore, specific conditions regarding listing duration, capital scale, business performance, liquidity, price fluctuation, and information transparency have not been clearly defined by current regulations. The SSC has also not issued additional criteria for short-selling securities. As a result, the practical implementation of short selling remains unfeasible.

Violations and penalties related to short selling in the securities sector are regulated under various legal documents, including the Securities Law 2019, Decree No. 158/2020/NĐ-CP, Decree No. 156/2020/NĐ-CP on administrative penalties in the securities sector, Decree No. 128/2021/NĐ-CP amending Decree No. 156/2020/NĐ-CP, Circular No. 120/2020/TT-BTC, and Circular No. 58/2021/TT-BTC.

Investor violations in short selling activities may include naked short selling^[19] and market manipulation through short selling^[20].

First, naked short selling is strictly prohibited under current regulations to ensure market transparency, stability, and fairness. According to Decree No. 156/2020/NĐ-CP on administrative sanctions in the securities sector, individuals and organizations engaging in such violations may face severe penalties, depending on the nature and extent of the violation. However, Vietnam currently lacks specific penalties for this offense. The authors suggest that Clause 2, Article 5 of Decree No. 156/2020/NĐ-CP could be applied to sanction naked short selling. The maximum administrative fine for violations in the securities sector is 3,000,000,000 VND for organizations and 1,500,000,000 VND for individuals.

Additionally, market manipulation includes placing buy and sell orders for the same security on the same trading day or colluding with others to conduct transactions without actual ownership transfer^[21]. These actions create artificial supply and demand, affecting stock prices for illegal profit. Violators may face fines amounting to ten times the illegal profit but not lower than the maximum fine under Clause 2, Article 5 of Decree No. 156/2020/NĐ-CP (3,000,000,000 VND for organizations and 1,500,000,000 VND for individuals) if the offense does not warrant criminal prosecution^[22]. In cases subject to criminal prosecution, individuals may face fines ranging from 2,000,000,000 VND to 4,000,000,000 VND or imprisonment from two to seven years. Legal entities may face fines from 5,000,000,000 VND to 10,000,000,000 VND or permanent suspension of business operations^[23].

Beyond monetary penalties, individuals and organizations found guilty may be subject to additional sanctions and remedial measures. These may include confiscation of all illegal profits obtained from the violation, suspension of securities business and services for a certain period (1–3 months), or revocation of securities practice certificates for 18–24 months for licensed professionals^[24]. These measures aim to deter fraudulent activities, protect investors' rights, and ensure a fair and transparent stock market.

4. Recommendations for Improvement for Vietnam

Firstly, expanding the range of securities eligible for short selling is essential. Based on short-selling regulations in the U.S. and Singapore, Vietnam can learn valuable lessons to improve its legal framework, ensuring a transparent and efficient stock market. Specifically, both the U.S. and Singapore have clear rules on the list of securities allowed for short selling, mainly including listed stocks, marginable securities, and highly liquid exchange-traded funds (ETFs). The goal of these regulations is to prevent price manipulation risks and limit excessive market volatility. Vietnam can adopt a similar approach by developing a list of short-sellable securities, prioritizing large-cap, highly liquid stocks listed on reputable exchanges.

Secondly, a mandatory short position reporting mechanism should be established to ensure market transparency, similar to Section 137ZK of Singapore's Securities and Futures Act (SFA) 2001. Failure to comply could be treated as fraud or intentional concealment of information.

Thirdly, strict control over naked short selling is necessary, following U.S. regulations, to prevent price manipulation and market risks. This can be enforced by requiring investors to have sufficient collateral before executing a short sale, with severe penalties for violations. The penalty could be up to three times the illegal profit gained or the avoided loss.

Fourthly, penalties for violations should be strong enough to serve as a deterrent, including heavy administrative fines and even criminal prosecution for serious offenses. Vietnam can learn from the U.S., where individuals committing serious violations may face fines of up to \$5 million or up to 20 years in prison, or both. In Singapore, penalties can reach up to SGD 500,000 or 7 years in prison, or both. Implementing such measures will help enhance transparency, reduce risks, and ensure the sustainable development of Vietnam's stock market.

Conclusion

Short selling is a crucial financial instrument that enhances market liquidity, provides a risk-hedging mechanism, and contributes to more efficient price discovery. However, due to its inherent risks of price manipulation and market instability, most countries enforce strict regulations to control this activity.

In developed markets such as Singapore and the United States, short selling is widely implemented with well-established regulatory frameworks. In Singapore, the range of securities available for short selling is diverse, covering stocks, investment funds, bonds, and derivatives. However, these transactions are subject to strict disclosure requirements and the ability to borrow securities. In contrast, the United States has a more complex legal structure, including Regulation SHO, which aims to prevent market manipulation through short selling and ensure market transparency.

Conversely, in Vietnam, short selling remains in its experimental phase with limited application, primarily within the derivatives market, where it is restricted to VN30 index futures contracts. Although legal provisions for covered short selling exist, the lack of detailed guidelines for implementation in the cash market has resulted in the practice being largely uncommon. This cautious approach reflects Vietnam's regulatory stance in safeguarding market stability and mitigating potential risks associated with short selling.

The differences in each country's approach to short selling reflect their financial market maturity and regulatory risk management strategies. Developed markets tend to expand the scope of shortable securities while establishing stringent enforcement mechanisms to mitigate risks. In contrast, emerging markets like Vietnam impose more restrictive measures to protect market integrity.

Overall, for Vietnam's stock market to develop sustainably and integrate more deeply into the global financial system, refining the legal framework for short selling is imperative. This would not only enhance market efficiency and investor access to advanced financial instruments but also strengthen oversight capabilities and improve risk management effectiveness.

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