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Short selling set to benefit stockbrokers

A securities firm's booth at an exhibition in Hainan province.
Shi Yan

The proposed introduction of margin trading and short selling on a trial basis is widely seen as part of government efforts to diversify financial instruments available to market participants and is expected to benefit domestic stockbrokers as their business range is expanded, analysts said.

The expected move follows recent measures aimed at boosting market sentiment, including a reduction in stamp duty on September 18 and State-owned enterprises being encouraged to purchase shares in their listed units.

The China Securities Regulatory Commission (CSRC) said on Sunday it would launch margin trading and short selling on a trial basis, with further details on approval procedures for qualified stockbrokers to be announced in the coming weeks.

Economists and industry analysts said the introduction of new trading mechanisms would mark a further maturing of the mainland's securities market, allowing for the addition of complex trading strategies.

"The new instruments will serve to increase overall market liquidity and the effectiveness of the market's price-setting mechanism," said Jing Ulrich, managing director and chairwoman of China Equities of JP Morgan. "The new trading mechanism will fundamentally change the 'one-sided' nature of the A-share market, allowing investors to profit from falling as well as rising markets."

"Investors will be able to utilize more sophisticated trading strategies, moving beyond simple buy-and-hold," Ulrich added.

The new financial instruments will first be unitized among a small number of qualified securities brokers and will be limited to a few stocks at the initial stage. Securities firms will be required to only use their own capital and stocks for lending to investors.

Zhou Liang, head of investment &advisory, China, Thomson Reuters, said the limitations would minimize the impact of the new measures in the trial period. Nevertheless, the proposal will have far-reaching consequences for the securities industry in general, particularly the business models of stock brokerages. "The introduction of the new services will of course help to diversify the income of securities firms," said Zhou Liang. But "the new services are not expected to make too great a contribution to their earnings, because the business they can do will be limited by their capital and in-house stock holdings".

By the end of 2007, the combined net capital of domestic securities firms totaled about 300 billion yuan ($43.81 billion), less than 6 percent of the market value of China's A shares, according to a report published yesterday by Industrial Securities Co.

The report showed that the combined share portfolios of all stock brokerages totaled 14.9 billion yuan by June 30, accounting for a mere 0.3 percent of the total market capitalization of the A share market.

Brokers and analysts warned investors should not neglect the leverage effect of both types of transactions, which could magnify potential risks.

Zhou and other analysts agreed that the first batch of qualified stockbrokers are expected to lend capital and stocks only to their core clients, mainly large fund management companies, corporate investors and high net-worth individuals.

In margin trading, investors borrow money from their stockbrokers to buy shares or fixed-income securities. In short selling, an investor sells shares he or she has borrowed from a stockbroker.

Brokers and analysts warned investors should not neglect the leverage effect of both types of transactions, which could magnify potential risks. Such a leverage effect is also seen as a reason why regulators have so far been cautious about introducing them on a trial basis.

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