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Overview of Short Selling in Securities: Analyzing Its Concept, Characteristics, Role, and Legal Framework

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Abstract

With the growth of short selling activities, there is limited research on its impact on the market and investors. This study investigates the short selling process and its role in price correction and enhancing liquidity, and providing risk management for investors. Data from markets in Vietnam, the US, and Singapore were collected for analysis. The findings reveal that short selling plays a critical role in

stabilizing stock prices, filtering out underperforming companies, and increasing market liquidity. However, this practice also presents significant risks to investors and can lead to considerable market volatility if not effectively regulated. This underscores the need for proper oversight and regulatory measures to ensure market stability.

Keywords: Short Selling, Securities Short Selling, Short Selling Process, Impact of Short Selling

Introduction

Securities short selling is an important financial tool that allows investors to profit from the declining prices of securities. It also plays a crucial role in enhancing liquidity and improving the market's operational efficiency. This activity has been present since the early days of financial markets and is now widely applied in many countries around the world. However, due to its unique nature, short selling also involves significant risks, requiring strict legal oversight to ensure market transparency and stability.

This article provides an overview of securities short selling, including its definition, characteristics, and the role of this activity for market participants. Additionally, the article analyzes the legal mechanisms regulating short selling, clarifying the necessity of legal regulations for this activity, as well as the content and role of these regulations in controlling short selling on financial markets.

Materials and Methods

Method of Analyzing and Synthesizing Legal Texts

The process of analyzing legal texts is aimed at clarifying the content and meaning of regulations, to understand the lawmakers' perspective and objectives. The goal of this process is to ensure the accurate, consistent application of the law, promoting fairness among the involved parties.

In the analysis process, special attention should be given to explaining key terms, especially those concepts that might be controversial or have multiple interpretations. Identifying the key terms of the text is also important in grasping the spirit of the legal norms.

Once the analysis is complete, the next step is to synthesize the key elements, evaluate the content from various perspectives, and identify both the strengths and limitations of the current regulations. More importantly, detecting legal gaps or shortcomings will serve as the foundation for proposing solutions for improvement, which will contribute to enhancing the effectiveness of legal enforcement.

Results and Discussion

1. Concept of Short Selling

Through research, it is evident that the concept of short selling is viewed from various perspectives. To clarify the concept of short selling securities, it is essential to understand the process involved. From an investor's perspective, the short selling process is conducted in the following steps:

Step 1 – Open a Margin Account: Before engaging in short selling, an investor needs to open a margin account with a brokerage firm authorized to perform securities brokerage activities. The margin account requires a minimum balance, known as the maintenance margin to ensure the payment of any potential losses.

Step 2 – Identify Securities to Borrow for Short Selling: The investor identifies securities that are likely to decrease in value by analyzing factors such as financial reports, industry trends, technical indicators, or market sentiment.¹ The investor also needs to borrow the securities to engage in short selling. Brokerage firms now offer automated services to help investors find securities available for borrowing from other clients or lending organizations.²

Step 3 – Place a Short Sale Order: After borrowing the securities, the investor decides to sell short and places a short sale order (market³ or limit order⁴) on the trading platform.⁵

Step 4 – Monitor the Short Position: After opening a short position, the investor must closely monitor market fluctuations and stock performance. The goal is for the stock price to drop, so the investor can repurchase the securities at a lower price. However, if the stock price rises, the potential losses are theoretically unlimited. The investor must also pay attention to the interest on the borrowed securities and margin requirements.⁶

¹ Hayes, A. (n.d.). Short Selling: Your Step-by-Step Guide for Shorting Stocks.2024. [cited 2025 Feb. 6] Retrieved from:

<https://www.investopedia.com/terms/s/shortselling.asp>.

² Beers, B. (n.d.). Short Selling: How It Works. 2024. [cited 2025 Feb. 16] Retrieved from:

<https://www.investopedia.com/articles/investing/100913/basics-short-selling.asp#:~:text=In%20a%20short%20sale%2C%20investors,buyback%20price%20is%20the%20profit>.

³ A market order is an order to buy or sell securities immediately at the current market price. Dhir, R. (n.d.). Market Order: Definition, Example, Vs. Limit Order. 2025. [cited 2025 Feb. 9] Retrieved from: <https://www.investopedia.com/terms/m/marketorder.asp#:~:text=A%20limit%20which%20instructs,most%20online%20broker%20pages>.

⁴ Dhir, R. (n.d.). Market Order: Definition, Example, Vs. Limit Order. 2025. [cited 2025 Feb. 9] Retrieved from: <https://www.investopedia.com/terms/m/marketorder.asp#:~:text=A%20limit%20which%20instructs,most%20online%20broker%20pages>.

⁵ Hayes, A. (n.d.). Short Selling: Your Step-by-Step Guide for Shorting Stocks.2024. [cited 2025 Feb. 6] Retrieved from: <https://www.investopedia.com/terms/s/shortselling.asp>.

⁶ Hayes, A. (n.d.). Short Selling: Your Step-by-Step Guide for Shorting Stocks.2024. [cited 2025 Feb. 6] Retrieved

Step 5 – Close the Short Position: To close the short sale, the investor repurchases the borrowed securities to return them to the lender. If the securities are bought back at a lower price than the selling price, the investor profits from the difference (after deducting interest and commission fees).⁷

Step 6 – Evaluate the Trade Results: After closing the position, the investor reviews and analyzes the trade's results to learn from the experience. Evaluating the factors that contributed to the success or failure of the trade helps the investor improve strategies for future short selling opportunities.⁸

As a provider of securities lending services and support for short selling, brokerage firms perform activities such as: (i) locating securities for short sale borrowing from other clients' accounts or third-party lenders; (ii) monitoring margin accounts to ensure investors maintain the minimum margin. If the stock price rises and the margin account drops below the required level, the brokerage firm may issue a margin call, requesting the investor to add funds or securities.⁹

Through the outlined process, it can be seen that from an investment perspective, short selling is considered a financial investment strategy that creates opportunities for profit in bearish markets. This strategy lets investors profit from the decline in securities' value. Specifically, the investor borrows securities from a brokerage firm and sells them short at the current price, then waits for the stock price to decrease, and buys back the securities at a lower price to return them to the firm. The profit comes from the difference between the short sale price and the repurchase price, less transaction costs.

Commonly understood, short selling is considered the act of selling securities that are not owned by the seller, with the seller borrowing securities from the market and later buying them back to repay the borrowed securities, in search of profit.¹⁰

According to the International Organization of Securities Commissions (IOSCO), a transaction is considered short selling if it meets two conditions: (i) it involves the sale of a

from:

<https://www.investopedia.com/terms/s/shortselling.asp>.

⁷ Hayes, A. (n.d.). Short Selling: Your Step-by-Step Guide for Shorting Stocks.2024. [cited 2025 Feb. 6] Retrieved from:

<https://www.investopedia.com/terms/s/shortselling.asp>.

⁸ Beers, B. (n.d.). Short Selling: How It Works. 2024. [cited 2025 Feb. 16] Retrieved from: <https://www.investopedia.com/articles/investing/100913/basics-short-selling.asp#:~:text=In%20a%20short%20sale%2C%20investors,buyback%20price%20is%20the%20profit>.

⁹ Dhir, R. (n.d.). Market Order: Definition, Example, Vs. Limit Order. 2025. [cited 2025 Feb. 9]. Retrieved from: <https://www.investopedia.com/terms/m/marketorder.asp#:~:text=A%20limit%20which%20instructs,most%20online%20broker%20pages>.

¹⁰ Finansinspektionen, *Short selling*. 2024. [cited 2025 Feb. 9]. Retrieved from: <https://www.fi.se/en/markets/investors/short-selling/>.

Congressional Research Service, *Short Selling: Background and Policy Issues*. 2023. [cited 2025 Feb. 9]. Retrieved from: <https://sgp.fas.org/crs/misc/IF12400.pdf>.

type of security, and (ii) the seller does not own the security at the time the sale is executed.¹¹

Mechanically, short selling is typically done through a margin account, which requires the investor to meet minimum margin requirements set by financial regulatory authorities or the broker. This ensures the investor's ability to pay in case the stock price does not drop as expected but increases, leading to the risk of losses.

Strategically, short selling is commonly used during market downturns when investors predict adverse factors affecting the value of a company or the entire industry. It is also used as a risk management tool in investment portfolios to reduce the negative impact of unfavorable price fluctuations. However, short selling carries significant risks, the most notable being the potential for stock prices to increase dramatically, leading to substantial losses. Additionally, the interest cost of borrowing the securities and the additional margin requirements increase the transaction costs for short selling.

Short selling is performed by investors for purposes such as profiting from declining prices, risk hedging, and re-evaluating asset pricing. Investors can profit when the asset price decreases compared to the time of the short sale. This strategy also serves as a risk management tool to protect the value of an investment portfolio from negative market movements. Moreover, short selling plays an essential role in adjusting asset values to more reasonable levels and supporting market liquidity.¹²

For brokerage firms, lending securities for short selling or assisting investors in borrowing securities to engage in short selling enables them to profit from service fees and margin interest. Brokers charge a loan fee when lending securities for short sales, with the fee depending on the liquidity and scarcity of the stock (the rarer the stock, the higher the fee). Additionally, investors often borrow money to maintain their short positions, and brokers generate revenue from margin interest when lending funds for trading.

In summary, short selling is a financial transaction where investors sell securities they do not own at the time of the trade, borrowing the securities from a brokerage or other market entity. The investor is obligated to repurchase the securities to repay the loan, with the goal of profiting from the decline in the securities' price.

2. Characteristics of Short Selling Securities

Through the study of the concept and process of short selling securities as mentioned above, it can be observed that this activity has several basic characteristics as follows: Firstly, the targets of short selling activities are very diverse. After researching the types of securities that can be short sold in Vietnam and some countries like the U.S. and Singapore, the authors noticed common points regarding the targets of short selling in these countries. Specifically, the securities that are allowed to be short sold are typically

¹¹ Regulation on Short Selling and Credit Default Swaps - Frequently asked questions. (n.d.). 2011. [cited 2025 Feb. 15]. Retrieved from: https://ec.europa.eu/commission/presscorner/detail/sv/memo_11_713.

¹² Hayes, A. (n.d.). Short Selling: Your Step-by-Step Guide for Shorting Stocks. 2024. [cited 2025 Feb. 6] Retrieved from: <https://www.investopedia.com/terms/s/shortselling.asp>.

stocks (including common and preferred stocks) that are listed and registered for trading on the stock exchange system. In countries with developed stock markets, the types of securities permitted for short selling are usually more varied, including not only stocks but also bonds, ETFs (in the U.S.)¹³ and Corporate Trust Funds, Real Estate Investment Trusts (REITs) (in Singapore)¹⁴. In Vietnam, the law currently permits investors to not only short sell stocks but also short sell fund certificates.

Secondly, the securities being short sold are not owned by the short seller. To execute a short sale, the investor typically borrows the amount of securities they wish to sell from other investors or from stock brokers. These securities are then sold at the current price and repurchased when the price drops to ensure repayment.¹⁵

Thirdly, the goal of the investor when engaging in short selling is to profit from the price decline of the securities being short sold. The investor sells the securities at the current price and later buys back the same amount of securities to repay the borrowed amount. When the securities are repurchased at a lower price, the short seller incurs lower costs compared to the money they received from selling the securities. The price difference between the short sale and repurchase at a reduced price allows the investor to gain a certain profit. This profit is the driving force for investors to engage in short selling.¹⁶

Fourthly, the entities involved in short selling include: (i) the short seller, (ii) the lender of securities for short selling, (iii) the securities company (broker), and (iv) organizations and entities that support short selling transactions. The short seller is an organization or individual who believes that the market price of a specific security will decline in the future, and they wish to borrow that security to sell and later repurchase it for profit. The lender of securities for short selling is typically a long-term investor who owns the securities the short seller wishes to borrow and is willing to lend the securities for a certain period to earn profit. The securities company acts as an intermediary, connecting the short seller and the securities lender and earning brokerage commissions. Additionally, the securities company manages the margin account, which records the securities lent to the short seller and ensures the fulfillment of the rights and obligations arising between the short seller and the lender of

¹³ Llanos, C. Investing in ETFs: What to consider. 2025. [cited 2025 Feb. 6]. Retrieved from: <https://www.chase.com/personal/investments/learning-and-insights/article/investing-in-etfs-what-to-consider#:~:text=The%20short%20answer%20is%20yes,lower%20price%20in%20the%20future>.

¹⁴ Driscoll, L. Short Selling in Singapore? 2023. [cited 2025 Feb. 6]. Retrieved from: <https://www.fundapps.co/blog/short-selling-in-singapore>.

¹⁵ What is short selling stocks? Characteristics, benefits and risks of short selling. (n.d.). 2023. [cited 2025 Feb. 10]. Retrieved from <https://wichart.vn/blogs/ban-khong-chung-khoan-la-gi-dac-diem-loi-ich-va-rui-ro-khi-ban-khong-408>.

¹⁶ What is short selling stocks? Characteristics, benefits and risks of short selling. (n.d.). 2023. [cited 2025 Feb. 10]. Retrieved from <https://wichart.vn/blogs/ban-khong-chung-khoan-la-gi-dac-diem-loi-ich-va-rui-ro-khi-ban-khong-408>.

securities for short selling.¹⁷ Moreover, the organizations and entities supporting short selling transactions meet the trading demands and assist in executing short selling securities transactions. In Vietnam, the entities supporting short selling transactions include the Vietnam Securities Depository and Clearing Corporation (VSDC) and the Vietnam Stock Exchange (VNX). Similar entities in the U.S. are the Depository Trust & Clearing Corporation (DTCC) (responsible for depository, settlement, and clearing of securities similar to VSDC) and the National Securities Clearing Corporation (NSCC) (a subsidiary of DTCC, which clears securities transactions to reduce settlement risks), and the stock exchanges (like the New York Stock Exchange (NYSE) and Nasdaq – where securities transactions, including short selling, take place). In Singapore, similar entities include the Singapore Exchange (SGX) (responsible for organizing and supervising trading activities, including short selling) and The Central Depository (CDP) (a unit under SGX, responsible for depository, settlement, and clearing of securities, similar to VSDC).

Fifthly, short selling activities involve significant risks for the short seller. First, the short seller faces liquidity risk. In cases where the short seller has borrowed securities for short selling but cannot sell them because there are no potential investors willing to buy those securities. Securities may lose liquidity due to various reasons, such as market fluctuations that reduce their attractiveness to potential investors, or the emergence of adverse information regarding the securities borrowed for short selling. This disadvantages the short seller, who must pay interest on the borrowed securities for short selling but cannot sell them.

Moreover, the short seller faces the risk of losses if the price of the securities increases (instead of decreasing as the investor expects). Since the short seller is obligated to return the borrowed securities, they must buy back the securities they sold at a higher price when the price has risen. This leads to the possibility of losses for investors involved in short selling.¹⁸

Additionally, the short seller may encounter margin risks. If the price of the shorted securities increases significantly, the securities company may issue a margin call, requiring the investor to deposit additional cash or securities into the margin account to increase collateral and maintain the short position. If the investor fails to meet the minimum margin requirement within a certain time frame (usually from two to five days), the securities company may sell securities (from the investor's portfolio) considered collateral for borrowing securities for short selling to meet the minimum margin requirement.¹⁹ If not, the securities company may close the

investor's short position, reclaim all borrowed securities, and retain the entire margin.²⁰

Furthermore, the short seller may face the risk of a short squeeze if the price of the shorted securities continues to rise, forcing many short sellers to buy back the securities they shorted to exit their losing positions. This creates a feedback loop that drives the price of the shorted securities even higher, forcing short sellers to buy securities at increasingly higher prices.²¹

A classic example of a short squeeze is the Gamestop (GME) incident in early 2021 in the U.S. Gamestop, a video game retail chain, had been struggling for several years.²² Before January 13, 2021, Gamestop was assessed by many large investors, especially hedge funds, as a company facing financial and business difficulties. They predicted the stock price would continue to fall, so they executed a short selling strategy. However, starting on January 13, 2021, a group of retail investors noticed that many hedge funds were aggressively short selling Gamestop stock, causing the short interest to exceed the available shares. This group began buying GME stock, causing a sudden spike in demand. When the stock price started to rise sharply, the short-selling hedge funds faced significant pressure to buy back the shares to cut their losses. This pushed the stock price even higher, creating an ongoing price increase cycle.²³

Sixthly, short selling securities also carries the risk of market manipulation. When large investors collaborate to short sell a large amount of securities simultaneously, the stock price can drop significantly. If they later buy back the shares at a lower price, they will make substantial profits from the price difference. This highlights the risk of price manipulation and speculation, which can negatively affect the market. However, the market can self-correct when other investors buy in, causing the stock price to rise again. Without strict control, collusion among short sellers can lead to severe consequences for the stock market.²⁴

3. Role of Short Selling Securities

3.1 Impact on the Stock Market

First, short selling helps regulate the prices of securities in the stock market. Short selling plays an important role in stabilizing the prices of securities. Specifically, when the

²⁰ Dieupq. The Complete Guide to Short Selling (+Real Life Examples). 2023. [cited 2025 Feb. 10]. Retrieved from <https://blog.fireant.vn/post/b%C3%A1n-kh%E1%BB%91ng>.

²¹ Ta Thanh Binh, *Short selling transactions - impact assessment and risk management recommendations for short selling transactions in Vietnam stock market*, Market Development Department (UBCKNN).2014; 24.

²² Hoài Thanh/Báo Tin tứcNPR, A. GameStop - the war that shook Wall Street and American politics. 2021. [cited 2025 Feb. 10]. Retrieved from <https://baotintuc.vn/phan-tichnhan-dinh/gamestop-cuoc-chien-lam-rung-chuyen-pho-wall-va-chinh-gioi-my-20210129162926688.htm>.

²³ (N.d.). 2021. [cited 2025 Feb. 10]. Retrieved from <https://www.cato.org/cato-journal/fall-2021/gamestop-episode-what-happened-what-does-it-mean#>.

²⁴ Tamplin, T. What Is Short Selling?: Equation, Squeezes, and Impact. 2023. [cited 2025 Feb. 10]. Retrieved from <https://www.financestrategists.com/wealth-management/stocks/short-selling/>

¹⁷ Le Vu Nam, Short selling activities need to be legalized in the Vietnamese stock market, *Journal of Legal Science, Ho Chi Minh City University of Law*.2013;1;39-44.

¹⁸ Short selling: Meaning, Benefits, Risk & Examples. 2024. [cited 2025 Feb. 10] Retrieved from <https://www.bajajfinserv.in/short-selling>.

¹⁹ Campbell, T. (n.d.). What to Know About Short Selling: How It Works, Strategies, Risks, Rewards. 2024. [cited 2025 Feb. 10]. Retrieved from <https://www.businessinsider.com/personal-finance/investing/what-is-short-selling>.

price of a stock rises too high compared to its intrinsic value, short sellers believe the market is mispricing the stock. They will sell a large amount of shares, even without owning them, creating selling pressure in the market. This results in the stock price decreasing to a more reasonable level, better reflecting its true value. As a result, short selling not only reduces the phenomenon of inflated stock prices but also prevents financial bubbles. This is a positive regulatory mechanism that helps maintain balance and efficiency in the stock market.

Second, short selling helps filter out inefficient companies. Through short selling, the short seller can express their opinion about the price trend of a stock issued by a specific company or their negative view on the company's business situation. For example, when short sellers notice issues such as poor management, uncompetitive products, or non-transparent financial reports in a company, they may decide to short the stock issued by that company²⁵. When short selling, the short seller can signal the financial condition or the poor outlook of the issuing company²⁶. This helps market participants identify companies with poor business performance.

Third, short selling contributes to increasing the liquidity of the stock market. Firstly, short selling increases the supply of securities, which helps increase the trading volume and liquidity of securities in the market²⁷. Additionally, short selling helps balance supply and demand in the market, preventing excessive price fluctuations. When stock prices rise too high, short selling can pull the price down to a more reasonable level; conversely, when stock prices fall deeply, short sellers can buy back the stocks to close their positions, pushing the stock price up. This process helps maintain stability and minimize excessive price fluctuations, contributing to increased market liquidity²⁸. Moreover, short selling helps determine the market value of securities involved in short selling on the stock market. Through short selling, investors can express their views on the price trends of securities issued by a specific company or their negative outlook on the company's business, as mentioned above. This contributes to determining the market price of stocks, increasing liquidity as investors feel more confident about their trading decisions.²⁹

3.2 Impact on Stock Investors

First, short selling is considered an investment strategy widely used by investors in developed stock markets, especially during market downturns. Rather than buying low and selling high, as in traditional investment strategies, short

selling allows investors to profit by selling stocks they do not own, expecting their prices to decrease in the future, and then buying them back at a lower price to make a profit.³⁰ For example, during the 2008 financial crisis, many investors used short selling strategies on stocks in the banking sector and made significant profits when the stock prices of large banks, such as Lehman Brothers in the U.S., collapsed in 2008.³¹

Short selling is also considered an effective tool for investors to protect their portfolios from unpredictable risks while optimizing profits in unfavorable market conditions (e.g., during a bearish market or when the stock prices of certain companies are expected to fall sharply due to macroeconomic factors or the company's internal issues).³² Specifically, instead of selling stocks from their portfolio, an investor can short sell stocks they do not own but expect to decrease in value and can borrow to do so. For example, when an investor sees a company facing financial difficulties or an unpromising business outlook, they may borrow the stock issued by that company to sell at a higher price. Later, if the stock price drops as predicted, the investor buys back the stock at a lower price to repay the lender and earn a profit. This strategy not only helps investors hedge against risks from weak stocks that could lower the overall portfolio's performance, but also creates opportunities to profit from accurately predicting market or specific stock price declines.

For instance, during the global financial crisis of 2008, many investors shorted stocks of banks and financial institutions when they predicted these companies would suffer large losses due to the downturn in the real estate market and bad debts. A prominent example is Michael Burry, a famous investor who predicted the collapse of the U.S. real estate market. Burry shorted financial instruments related to bad debts and made a huge profit when the market collapsed, while many other investors suffered heavy losses.³³

Additionally, short selling stocks similar to the ones held in the portfolio is another strategy used by many investors to hedge their portfolio against market volatility. This is a form of risk mitigation where an investor holds stocks of two companies in the same industry or with similar business models. When the broader market fluctuates, these two stocks often increase or decrease together. This means that profits from the stronger stock can offset losses from the

²⁵ Arturo Bris, William N. Goetzmann và Ning Zhu, Efficiency and the Bear: Short Sales and Markets Around the World, *The Journal of Finance*. 2007; 62; 1029-1079.

²⁶ Charles M. Jones và Owen A. Lamont, Short-sale constraints and stock returns, *Journal of Financial Economics*. 2002; 66; 207-239.

²⁷ Karl B. Diether, Kuan-Hui Lee và Ingrid M. Werner, Short-sale strategies and return predictability, *The Review of Financial Studies*. 2009; 22; 575-607.

²⁸ Ekkehart Boehmer, Charles Jones và Xiaoyan Zhang, Which shorts are informed?, *The Journal of Finance*. 2008; 63; 491-527.

²⁹ Paul Asquitha, Parag A. Pathak và Jay R. Ritter, Short interest, institutional ownership, and stock returns, *The Journal of Financial Economics*. 2005; 78; 243-276.

³⁰ Beers, B. (n.d.). Short Selling: How It Works. 2024. [cited 2025 Feb. 16] Retrieved from: <https://www.investopedia.com/articles/investing/100913/basics-short-selling.asp#:~:text=In%20a%20short%20sale%2C%20investors,buyback%20price%20is%20the%20profit.>

³¹ Lioudis, N. (n.d.). The Collapse of Lehman Brothers: A Case Study. 2024. [cited 2025 Feb. 16]. Retrieved from <https://www.investopedia.com/articles/economics/09/lehman-brothers-collapse.asp>.

³² Jones, Charles P, *Investments: Analysis and Management*, MPS Limited, Berkeley. 2012; 315-316.

³³ Lewis Michael, *The Big Short: Inside the Doomsday Machine*, W.W. Norton & Company, New York. 2010; 108-112.

weaker stock, helping the investor maintain stability in their portfolio.³⁴

A typical example is in the oil industry, where oil prices can fluctuate greatly due to geopolitical and global economic factors. An investor may hold stocks of a large oil company like ExxonMobil, established in 1999 in the U.S., while shorting stocks of a smaller company more sensitive to oil price changes, like Chesapeake Energy, listed on the NASDAQ. When oil prices fall sharply, both stocks' prices may decrease, but the profits from ExxonMobil shares could help mitigate losses from the short sale of Chesapeake Energy stocks.³⁵

Thus, short selling securities is not only an effective risk-hedging strategy but also a powerful tool to help investors maximize profits in adverse market conditions. By applying this strategy flexibly and creatively, investors can protect their assets from unforeseen market movements and generate profits even during market downturns.

3.3 Impact on Securities Brokerage Firms

Short selling provides numerous financial and strategic benefits to securities brokerage firms, including increasing revenue from transaction fees, margin interest, improving market liquidity, and attracting large clients.

First, short selling generates significant revenue for securities firms through transaction fees and margin interest. When investors engage in short selling, they need to borrow securities from the brokerage firm or other lending institutions, and the firm charges a fee for this service. Additionally, most short selling transactions are conducted through margin accounts, meaning the investor must borrow money from the brokerage firm to maintain their position. This loan incurs margin interest, which the investor is obligated to pay, providing a key source of income for the brokerage firm. Notably, during periods of high market volatility, when the number of short selling transactions increases, the firm's revenue from transaction fees and margin interest grows, contributing to optimizing their profits.

Moreover, short selling plays a key role in increasing transaction volume and improving market liquidity. When investors engage in short selling, the number of trades on the stock exchange rises, boosting market activity and creating more trading opportunities. This not only allows the brokerage firm to collect more transaction fees but also supports a more efficient market. Furthermore, high liquidity helps the brokerage firm execute buy and sell orders for clients without facing payment difficulties, enhancing the quality of services and attracting more investors to the market.

Additionally, the brokerage firm acts as an intermediary in assisting investors in borrowing securities to conduct short selling transactions. Through their system, the firm connects investors with investment funds, financial institutions, or uses the securities they manage for lending. Offering this

service not only helps the market run more efficiently but also generates significant revenue for the brokerage firm. Especially with rare stocks or those with low liquidity, the securities lending fees tend to be higher, providing an opportunity for the firm to optimize its profits. As a result, securities lending becomes an important business area, allowing the firm to diversify its revenue streams and enhance its asset management capabilities.

Furthermore, short selling plays a crucial role in attracting and retaining clients, particularly professional investors. Hedge funds, large investment funds, and professional investors often use short selling as an essential trading strategy to optimize profits and manage portfolio risks. Therefore, brokerage firms that provide short selling support services, including securities lending and margin accounts, will become the preferred choice for these clients. Maintaining relationships with institutional investors not only helps the brokerage firm increase revenue from transaction fees and margin interest but also generates stable, long-term profits, enhancing its competitive position in the market.

4. Overview of the Legal Framework Governing Short Selling of Securities

4.1 The Necessity of Regulating Short Selling of Securities by Law

The regulation of short selling by law is essential to ensuring transparency, stability, and fairness in the securities market. If not strictly controlled, short selling can lead to significant risks, including stock price manipulation, erosion of investor confidence, and market instability. Legal provisions governing short selling aim to protect investors' legitimate interests, particularly retail investors, by mandating trade disclosure and enforcing strict oversight against manipulative practices.

Additionally, legal regulations play a crucial role in preventing excessive short selling, mitigating adverse impacts on stock prices, and averting financial crises. Establishing a robust legal framework not only fosters a fair competitive environment but also contributes to the sustainable stability of the economy. Thus, law serves as a vital instrument in regulating short selling, balancing the interests of market participants, and maintaining market order.

In general, the legal framework governing short selling of securities encompasses a body of legal norms enacted by competent state authorities, regulating social relations arising from short selling activities to ensure market transparency and stability. These regulations focus on defining essential conditions for shortable securities, short sellers, and brokerage firms to ensure transparency, mitigate investor risks, and maintain market stability.

Specific legal provisions include requirements on eligible securities for short selling, minimum margin requirements, and the short selling process (from borrowing securities, executing short sales, to repaying borrowed securities). Furthermore, short selling regulations impose risk control measures by limiting short selling ratios and implementing protective mechanisms during market distress.

Moreover, legal regulations address market manipulation, fraud, and mandate transaction disclosure, with strict penalties to uphold market discipline. The primary objectives of short selling regulations are to protect investor rights—especially retail investors—by reducing risks and

³⁴ Hull, John C, *Risk Management and Financial Institutions*, John Wiley & Sons, New Jersey. 2023; 289-290.

³⁵ Richard A. Brealey, Stewart C. Myers và Franklin Allen, *Principles of Corporate Finance*, McGraw-Hill Education, New York. 2017; 432-433.

preventing stock price manipulation. At the same time, these regulations enhance market transparency through mandatory disclosures and stringent transaction oversight, while also controlling risks and curbing excessive short selling.

Beyond risk mitigation, legal provisions promote sustainable market development, bolster investor confidence, create a competitive trading environment, and enhance the international competitiveness of financial markets. Regulations governing short selling also establish penalties for violations, such as unauthorized short selling, failure to disclose information, or regulatory evasion. Additional sanctions may include trading suspensions, revocation of short selling privileges, or temporary bans from market participation to serve as deterrents.

In severe cases, such as stock price manipulation or securities fraud, legal measures may entail criminal liability depending on the nature and severity of the offense. Violators may also face civil liabilities, including compensatory damages for affected parties and restitution of illicit gains. Additionally, regulatory authorities may mandate corrective measures, such as nullifying unlawful transactions or restoring investor rights.

The legal framework for short selling consists of both substantive and procedural legal provisions to comprehensively regulate this activity. Substantive legal rules define the rights and obligations of market participants, specifying conditions and entities permitted to engage in short selling, eligible securities, margin requirements, repayment periods, and prohibitions against fraud and price manipulation. These laws also establish investors' responsibilities in adhering to disclosure requirements and accurate reporting.

Simultaneously, procedural legal rules outline the processes and mechanisms for enforcing substantive regulations, including registration procedures for short selling transactions, oversight mechanisms by regulatory authorities, and procedures for addressing violations. These provisions ensure market transparency and fairness while creating an effective enforcement framework for resolving disputes and regulatory breaches, ultimately safeguarding investors and upholding the financial market's stability.

4.2 The Role of Legal Regulation in Short Selling of Securities

Firstly, protecting investors' rights and legitimate interests. The legal framework governing short selling plays a crucial role in safeguarding the rights and interests of investors, particularly retail investors. By establishing regulations on information transparency, margin requirements, and protective measures, the law helps mitigate risks arising from fraudulent activities, market abuse, and stock price manipulation. As a result, investors can participate in the market with greater confidence and security.

Secondly, ensuring market transparency and fairness. The law clearly defines the conditions and procedures for conducting short selling, ensuring that all transactions are executed openly and in compliance with regulations. Legal provisions require investors and securities firms to provide complete and accurate information while adhering to established trading standards. This contributes to creating a transparent and fair trading environment while minimizing conflicts of interest within the market.

Thirdly, maintaining financial market stability and sustainable development. Short selling regulations are

designed to manage risks and prevent negative impacts such as price manipulation or excessive short selling, which could destabilize the market. Supervisory, regulatory, and enforcement measures are implemented to maintain market order and ensure the stable operation of financial markets. Consequently, legal regulations provide a foundation for sustainable market growth and attract further investment capital.

Conclusion

This research highlights the critical role of short selling in regulating stock prices, enhancing liquidity, and filtering out inefficient companies. The findings indicate that short selling not only helps stabilize the market but also offers opportunities for investors to profit in adverse market conditions. However, the study also reveals significant risks associated with short selling, including liquidity risk, margin calls, and strong market volatility, all of which necessitate strict supervision and management to ensure the stability of financial markets. This research contributes to a better understanding of the impact of short selling in markets such as Vietnam, the U.S., and Singapore. However, the scope of this study could be expanded to examine the legal regulations and monitoring mechanisms of short selling in other countries, thereby contributing to the improvement of global short selling policies and regulations, ensuring the sustainable development of securities markets.

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