

## FAQs on Comprehensive Revision to Short Selling Regulations

October 31, 2013

Tokyo Stock Exchange, Inc.

(Note) This FAQ has been prepared to help deepen your understanding of the most frequently asked questions, and some sections are intentionally brief for the sake of simplicity. For more detailed information, please refer to the relevant laws and regulations.

## FAQ Table of Contents

1.	Overview of Comprehensive Revision of Short Selling Regulations .....	3
	(Q1-1) Summary of revision .....	3
2.	Trigger-Based Price Restriction .....	4
	(Q2-1) Summary of price restriction .....	4
	(Q2-2) Meaning of trigger .....	4
	(Q2-3) Trigger price calculation method .....	5
	(Q2-4) Determining trigger breaches .....	5
	(Q2-5) Checking for trigger breaches .....	6
	(Q2-6) Price restriction after trigger breach .....	6
	(Q2-7) Handling of stocks exempted from price restriction .....	6
	(Q2-8) Confirming the issues subject to price restrictions on the following day .....	7
	(Q2-9) Time of trigger breach and start of price restriction .....	7
	(Q2-10) Determination of quote price and trigger breach .....	8
	(Q2-11) Stop allocation and trigger breach determination .....	8
	(Q2-12) Applicable period of price restriction .....	8
	(Q2-13) Determining the primary market .....	9
	(Q2-14) Publication of primary markets .....	9
	(Q2-15) One-touch price restriction .....	9
	(Q2-16) Flagging before trigger breach .....	10
	(Q2-17) Flagging margin and short selling .....	10
	(Q2-18) Conditions for placing a short selling order with price restriction .....	11
	(Q2-19) Suspension of trading when triggers are breached .....	12
3.	Outstanding Short Selling Position Reports .....	12
	(Q3-1) Scope of calculation for outstanding short selling position reports .....	12
	(Q3-2) Level of outstanding short selling position ratio requiring reporting .....	12
	(Q3-3) Items to be included in the new format .....	13

(Q3-4) Whether voluntary reporting is required ..... 1 3  
(Q3-5) Individuals reporting stocks with outstanding short selling ratio of 5% or more ..... 1 3  
(Q3-6) Correction of outstanding short selling position reports ..... 1 4

## 1. Overview of Comprehensive Revision of Short Selling Regulations

### (Q1-1) Summary of revision

What will change in the short selling regulations as a result of this review?

The comprehensive revision of short selling regulations, which will take effect on November 5, 2013, will take into account the trends of regulations in other countries. Currently, Japan's short selling regulations can be broadly classified into five major categories, and an overview of each regulation and its major revisions are as follows.

#### (1) Obligation to clarify a short selling order

When a sell order is placed, it must be clearly stated and confirmed whether or not it is a short sale.

#### (2) Price restriction

This rule imposes certain restrictions on the price at which a short selling order can be placed. Specifically, the rule prohibits short selling at a price "at or below" the most recently announced price in the case of an uptick (in which the most recently announced price is higher than the previous price), and prohibits short selling at a price "below" the most recently announced price in the case of a downtick (in which the most recently announced price is lower than the previous price). This is also known as the "uptick" rule.

In this revision, the current price restrictions which are usually applied will henceforth be replaced by trigger-type price restrictions, which are similar to those implemented in the US.

#### (3) Obligation to confirm settlement measures

This rule was intended to prohibit naked short selling, which is short selling not covered by corresponding holdings or borrowings of the underlying stock. It was introduced as a temporary measure after the collapse of Lehman Brothers in September 2008, and has been repeatedly extended to the present.

In the current revision, the time-limited framework will be abolished and made a permanent measure.

#### (4) Outstanding short selling position reporting system

TSE requires investors to report their outstanding short selling position information (name, address, issue, short selling position ratio, etc.) when their short selling position ratio is 0.25% or more and the number of outstanding short selling units traded exceeds 50 units. (In the case of an individual, their name and address will not be made public unless their short selling position ratio is 5% or more). This rule was also introduced as a temporary measure after the Lehman Brothers collapse in September 2008, but has since been repeatedly extended to the present.

The current "One-Tier Model" (where 0.25% or more is reported and disclosed) will be replaced by the "Two-Tier Model" (where 0.2% or more is reported and 0.5% or more is disclosed), which has been implemented in Europe. In addition, the time-limited framework will be abolished and made a permanent measure.

(5) Restrictions on short selling in connection with public offerings for capital increase

In the case of a public offering or secondary offering, stocks acquired in response to such public offering or secondary offering must not be used to settle the borrowing of stocks for short selling made during the period when the price of the stock has not been determined.

Currently, the rules of Japan Securities Dealers Association (JSDA) impose similar short selling restrictions on transactions on proprietary trading systems (PTS) (excluding short selling restrictions on public offerings), and the current revision will impose the same short selling restrictions as those on exchanges under the law.

2. Trigger-Based Price Restriction

(Q2-1) Summary of price restriction

How does the trigger-based price restriction work?

Under the existing short selling regulations, price restrictions are always applied to all issues (constantly applied), but with the recent revision, price restrictions will be applied only to issues that breach triggers (trigger-based price restriction). Since each issue will be judged on a case-by-case basis as to whether or not it has breached the trigger, there will be some issues to which price restrictions are applied and some issues to which price restrictions are not applied, depending on the price movement of each issue.

(Q2-2) Meaning of trigger

What is a trigger?

The trigger for price restriction is defined as "execution at a price that is 10% or less than the base price." Since the "base price" is, in principle, the closing price of the previous day, trigger-based price restrictions mean that the price restrictions are applied immediately after the stock price falls 10% or more from the previous day's closing price. For example, if the closing price of a stock is JPY 100 on the previous day, the price restriction will be applied immediately after the stock price falls below the trigger price of JPY 90 on the same day.

(Q2-3) Trigger price calculation method

How is the trigger price calculated?

The trigger price will be calculated as "90% of the base price" (any fraction less than tick prices for quotes will be rounded down).

In principle, the "base price" is the closing price of the previous day, but if the previous day is the final day of the ex-rights period (ex-rights date), the base price is the price adjusted for the relevant rights. For example, if the closing price of a stock that will pay a dividend of JPY 5 is JPY 100 on the previous day and the next day is the ex-dividend date, its base price will be JPY 95 (i.e., JPY 100 – JPY 5). If the closing price of a stock undergoing a 1:2 split is JPY 100 on the previous day and the next day is the ex-rights date, its base price will be JPY 50 (i.e., JPY 100 ÷ 2).

In the case where a special quote or sequential trade quote is displayed on the previous day before the close of trading (where an issue closes on a quote price instead of a traded price), the relevant final quote price will be the base price.

TSE will use the same price as the base price of the daily price limit as the base price for such price restrictions.

(Q2-4) Determining trigger breaches

How do you determine that the trigger has been breached?

The trigger price is 90% of the base price, and a trade is considered to have breached the trigger when it is executed at a price at or below this price.

For example, for an issue with a base price of JPY 100, the trigger would not be breached until a trade is executed at JPY 91, but if a trade is executed at JPY 90 or below, the trigger would be breached and the price restriction would be immediately applied. 90% of the price of a stock with a base price of JPY 99, 90% would be JPY 89.1, but since the tick price is JPY 1, the trigger would not be breached at JPY 90. However, the trigger would be breached if the stock were to be executed at JPY 89 or below.<sup>1</sup>

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<sup>1</sup> In accordance with the "Optimization of Tick Sizes (Phase II)" scheduled for July 2014, the tick size of TOPIX 100 constituents will be reduced to JPY 0.1 increments in the relevant price range. In this case, the trigger would not be breached when a trade is executed at JPY 89.2, and the trigger would be breached when a trade is executed at JPY 89.1 or lower.

(Q2-5) Checking for trigger breaches

Where can I find out if a trigger has been breached?

Since the trigger price is 90% of the day's base price, each trading participant or investor can calculate the trigger price and determine whether it has been breached or not, but TSE will also distribute information on trigger breaches in real time through the Market Information System.<sup>2</sup> (If you do not obtain market information directly from TSE, please note that how this information is handled may vary depending on the information vendor you use.)

In addition, stocks that breach the trigger on any given day will be published on the following page along with the time of the breach and name of the primary market.

(Reference) Information on stocks for which the trigger has been breached

<https://www.jpx.co.jp/english/markets/equities/ss-reg>

(Q2-6) Price restrictions after trigger breach

Are there any changes to the price restrictions that apply after the trigger has been breached?

There will be no change in the price restrictions that apply after a trigger breach. The same uptick rule of prohibiting short selling below the most recently announced price will be maintained as before (when the most recently announced price is higher than the previous price) and short selling at or below the most recently announced price is prohibited in a downtick situation (when the most recently announced price is lower than the previous price).

(Q2-7) Handling of stocks exempted from price restrictions

With this revision, will price restrictions be applied to new margin sales of 50 units or less by individuals, etc., which were not subject to price restrictions in the past, after the trigger breach?

Transactions that are exempted from price restrictions, such as new margin sales of 50 units or less by individuals and such transactions that are exempted from the application of price restrictions (as defined in Article 11 of the Cabinet Office Ordinance on Restrictions on Securities Transactions (Cabinet Office Ordinance No. 59 of 2007; hereinafter referred to as "the Ordinance")) and transactions that are exempted from the clarification obligation (Article 15 of the Ordinance) will not

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<sup>2</sup> Please refer to the "Disclosure of Connection Specifications (Revised Version) for Comprehensive Review of Short Selling Regulations" (TSE Market Information System No. 28) dated May 17, 2013 for the changes in the price dissemination system due to the revision of the short selling regulations.

be subject to price restrictions, regardless of whether the trigger has been breached, even after this revision.

Please note that TSE will determine whether price restrictions apply based on the short selling flags (hereinafter simply referred to as "flags") assigned by trading participants and investors, so please make sure to attach the correct flag to each order. Please also refer to Q2-16 for more information on how to attach flags.

(Reference) Application of short selling flags and price restrictions before and after the rule revision

	Before revision	After revision
Short selling with price restrictions (Flag 5)	Price restrictions always apply	Price restrictions apply only after trigger breach
Short selling with no price restrictions (Flag 7)	No price restrictions applied	Same as on the left
Long sale and exemptions from clarification obligation (Flag 0)	No price restrictions applied	Same as on the left

(Q2-8) Confirming the issues subject to price restrictions on the following day

Where can I find a list of issues that will be subject to price restrictions the next day?

This information is posted in CSV format on the following page for reference.

(Reference) Information on stocks for which the trigger has been breached

<https://www.jpx.co.jp/english/markets/equities/ss-reg>

(Q2-9) Time of trigger breach and start of price restrictions

Is it correct to assume that the time listed in the "List of Triggered Stocks" published on the TSE website is the time from which the price restrictions apply?

The "List of Triggered Stocks" published daily on the TSE website is for TSE-listed issues that were executed on the TSE auction market at a price 10% or less than the base price on that day. Therefore, the time listed in the "Triggered Time" column does not necessarily indicate the time from which the price restrictions are applied.

For example, even if the trigger had already been breached on the previous day and the price restriction is applicable for the entire day, if a trade is executed at a price 10% or less than the base price again on the same day, that second time will be listed (Please see Q2-12 for the application of price restrictions on the following day).

The start time of the price restrictions can be determined by means such as comparing the list of stocks that triggered on the previous day with the list of stocks that triggered on the next day.

(Q2-10) Determination of quote price and trigger breach

Is it correct to assume that if the sell special quote price is moving down, the trigger has not been breached because no execution has occurred?

Since quote prices (prices at which special quotes or sequential trade quotes are displayed) are not taken into account when determining whether a trigger has been breached, if no trade has been executed, the order is not considered to have breached the trigger. However, please note that short selling orders with Flag 5 (short selling orders with price restrictions) cannot be placed as market orders (including funari orders, or limit orders that become market orders at the closing auction if not already executed) or limit orders at prices at or below the trigger price, even before the trigger is breached (For order prices and conditions before and after the trigger is breached, please refer to Q2-18 for order prices and conditions before and after a trigger breach.).

(Q2-11) Stop allocation and trigger breach determination

There were many sell orders from the start of the morning session, and at 3:00 p.m., trading was only executed by stop allocation at the lower limit price. In this case, how is the trigger breach determined?

As described in Q2-10, a trigger breach is not considered to have occurred while a special quote is displayed, but in this case, matching was executed at the stop allocation at 3:00 p.m., so the trigger is considered to have been breached at this time. If the primary market for this issue is TSE, the price restrictions will be applied for the whole of the next business day (Please refer to Q2-12 for the application of price restrictions on the following day.).

(Q2-12) Applicable period of price restrictions

If the trigger is breached, how long will price restrictions apply?

If an issue whose primary market is TSE (Article 12, Paragraph 7 of the Ordinance) breaches the trigger on TSE, price restrictions will be applied until the close of the auction on the next business day. However, if an issue whose primary market is not TSE breaches the trigger on TSE, price restrictions will be applied until the end of the trading session on that day, but whether the price restrictions are applied on the following business day will depend on the status of the trigger



breach on the primary market. For example, if an issue on the Nagoya Stock Exchange (NSE) is triggered on TSE, price restrictions will be applied on TSE from the time the TSE trigger is breached until the end of the auction on that day, but whether the price restrictions will be applied on the following business day will be determined based on whether the trigger was breached on its primary market (NSE).

(Q2-13) Determining the primary market

How do I know which market is the primary market?

The financial instruments exchange market with the highest total trading volume for the six-month period beginning at the end of the previous month will be the primary market for the issue (Article 12, Paragraph 7 of the Ordinance). Information on the primary market for each issue will be posted on the following page at the end of each month.

(Reference) Information on primary markets

<https://www.jpx.co.jp/english/markets/equities/ss-reg/01.html>

(Q2-14) Publication of primary markets

Is the primary market only published at the end of the month?

In the event that a change in the primary market announced at the end of the previous month, information will be posted during the next month in Excel format on the following page as reference information.

(Reference) Information on principal markets

<https://www.jpx.co.jp/english/markets/equities/ss-reg/01.html>

(Q2-15) One-touch price restrictions

If the price of a stock rises immediately after a trigger breach, do the price restrictions still apply?

Trigger breaches will be determined in a one-touch manner, meaning that once the trigger is breached, price restrictions will continue to apply for at least the rest of the day, even if the price subsequently rises. How this is handled on the following day will depend on whether the trigger was breached in its primary market (Please refer to Q2-12 for the application of price restrictions

on the following day).

(Q2-16) Flagging before trigger breach

For margin transactions and other transactions involving more than 50 units for individuals, orders are placed with price restrictions (Flag 5), but since price restrictions are not applied before the trigger is breached, should orders be placed without price restrictions (Flag 7)?

In this case, orders must be placed with Flag 5 even before the trigger is breached. In accordance with Article 8 of the Rules Concerning Bids and Offers, TSE stipulates that short selling orders must be placed separately for transactions that are exempt from the application of price restrictions (as defined in each of the items of Article 15, Paragraph 1 of the Ordinance) and those that are not. Whether or not a transaction falls within the scope of transactions exempted from the application of price restrictions is determined by the nature of the transaction, regardless of whether or not price restrictions are actually applied to the issue at the time the short selling order is placed. In other words, short selling orders that do not fall under the price restriction exemption by nature of the transaction must always be placed as a short selling order with price restrictions (Flag 5), even if it is before the trigger has been breached (during the period when price restrictions are not applied).

Short selling by individuals through margin trading in excess of 50 units are not transactions that fall under the exemptions from price restrictions (transactions that fall under each item of Article 15, Paragraph 1 of the Regulations on Trading Regulations), so they should always be placed as short selling orders with price restrictions (Flag 5).

(Q2-17) Flagging margin and short selling

Orders have been placed for margin sales of 50 units or less by individual investors with a "2" as the margin transaction flag and a blank for the short selling flag. Is it necessary to change this method of placing orders with the current revision?

After this revision, the same order placement<sup>3</sup> will be fine.

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<sup>3</sup> Please refer to the "Points to Note Concerning Application of Price Regulations to Sales, etc. through Margin Transactions, etc." (TSE Margin No. 526) dated September 12, 2002.

(Q2-18) Conditions for placing a short selling order with price restrictions

At what price and under what conditions can short selling orders with price restrictions be placed (Flag 5)?

(1) Market orders (including on-the-close, market-on-close, and funari (limit-to-market on close) orders)

Orders are not allowed and will be handled in the same manner after this revision.

(2) Limit orders

The handling of limit orders will change before and after a trigger breach.

Before the trigger is breached, there will be no price check based on the uptick rule, but from the perspective of preventing price restriction breaches, limit orders at or below the trigger price will not be allowed.<sup>4</sup> After the trigger is breached, limit orders below the trigger price will be accepted, but order acceptance will be determined based on the uptick rule as before.

(3) Limit price (auction) with closing condition

The price is not determined at the time of order placement, but is determined based on the price of the previous trade at the end of the auction and whether there is a trigger breach, at which point the acceptance or rejection of the order will be determined.

(Reference) Types of orders and their decisions before and after the rule revision

	Before revision	After revision
Market order	Not allowed	Same as on the left
Limit order	Determined according to the uptick rule	(Before trigger breach) Limit orders at or below the trigger price cannot be placed
		(After trigger breach) Determined according to the uptick rule
Limit price (auction) with closing condition	Determined according to the uptick rule at the close of the continuous auction	(Before trigger breach) Limit orders at or below the trigger price expire at the close of the continuous auction
		(After trigger breach) Determined according to the uptick rule

<sup>4</sup> Please note that this is not a limit order for a price "below" the trigger price. If the trigger price is 90 yen, a limit order for Flag 5 to sell at 90 yen cannot be placed before the trigger price is breached.

		at the close of the continuous auction
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(Q2-19) Suspension of trading when triggers are breached

After the trigger is breached, will trading be halted or any other measures be implemented?

Trading will not be suspended and price restrictions will be applied immediately to the issue in question.

3. Outstanding Short Selling Position Reports

(Q3-1) Scope of calculation for outstanding short selling position reports

Has the scope of the calculation for outstanding short selling position reports changed?

In accordance with the revision, outstanding short sales from private trading systems (PTS) and off-market transactions, in addition to on-exchange transactions, must now also be reported as outstanding short selling positions. In addition, short selling positions from off-auction trading, which were previously excluded from the calculation of exchange-traded transactions, will now be included in the calculation.

(Q3-2) Level of outstanding short selling position ratio requiring reporting

After the rule revision, do we report when the outstanding position changes by more than 0.1% from the previously reported outstanding short selling position ratio? For example, for an outstanding short selling position ratio of 0.25%, does that mean the next level requiring reporting is 0.35%?

No. In this case, you must report when the outstanding short selling position ratio reaches 0.3% or more.

Under the revised rules, when there is a change in the outstanding short selling position, it must be reported when there is a change to the first decimal place in the outstanding short sale position ratio before and after the change (Article 15-2, Paragraph 6, Item 2 of the Ordinance). Thus, for example, if the outstanding short selling position ratio changes from 0.25% to 0.31% to 0.35% to 0.39% to 0.40%, you are required to report when the ratio changes from 0.25% to 0.31% and from 0.39% to 0.40%.

(Q3-3) Items to be included in the new format

The reporting format for TSE has changed. When should I start using the new reporting format? Can you please elaborate on how to use the new reporting format?

Please use the new format beginning with the outstanding short selling position report on November 5, 2013.

It is still possible to use the new format before then, but in that case, you will need to report in accordance with the items and reporting deadlines stipulated in the laws and regulations prior to the revision. In addition, as before, we ask that you submit the PDF file in a compressed ZIP format.

For other items to be included in the new format and the method of publication, please refer to Exhibit 2 of the "Handling of Outstanding Short Selling Position Reporting, etc. in Relation to the Comprehensive Revision of Short Selling Regulations" (TSE Equities, No. 211) dated September 4, 2013 (the same material is also available on the following page).

(Reference) Information on outstanding short selling positions

<https://www.jpx.co.jp/english/markets/public/short-selling/index.html>

(Q3-4) Whether voluntary reporting is required

If the outstanding position only changes from 0.25% to 0.26%, there is no need to report the change under the rules, but can we voluntarily report such cases anyway?

It is acceptable to voluntarily submit reports in excess of the legal requirements. In that case, the percentage of the most recent outstanding short selling position should be the actual last reported figure, including the portion that is voluntarily reported.

(Q3-5) Individuals reporting stocks with outstanding short selling ratio of 5% or more

If an individual has one stock with an outstanding short selling ratio of 5% or more and one with outstanding short selling ratio of less than 5%, do they need to be reported separately?

Under the law, the name and address of an individual with an outstanding short selling ratio of less than 5% will not be disclosed, so if an individual has an outstanding short selling ratio of 5% or more and an outstanding short selling ratio of less than 5%, please report each ratio separately.

(Q3-6) Correction of outstanding short selling position reports

There was an error in the figures previously reported in the outstanding short selling position report, how do I report the correction?

Please name the file "YYYYYMMDD\_Provider\_name-1\_Correction" (YYYYYMMDD is the date of calculation of the outstanding short selling position ratio based on laws and regulations) and submit the report again with the correct information only for the outstanding position relating to issues for which there were errors. In doing so, please indicate in the remarks column the name of the items that contained the error and the details of the report before the correction.