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Can Short Selling Improve Corporate Investor Protection? : A Case Study of CITIC Securities

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Abstract:

This paper takes the "Huge Loss Gate" incident of CITIC Securities as the research object, and explores the impact of the short-selling mechanism on corporate investor protection by combining the practice of short selling through margin trading in China. The study finds that in a weak legal risk environment, although margin selling theoretically has a price discovery function, the spread of false negative information leads to abnormal stock price fluctuations, and the imbalance between short-selling profits and violation costs weakens investor protection. The study indicates that improving the legal supervision system and strengthening information disclosure constraints are prerequisites for the short-selling mechanism to enhance investor protection.

Keywords: Short-selling Mechanism, Investor Protection, CITIC Securities, Legal Supervision

1. Introduction

1.1 Research Background

China's capital market has long been in a "one-way market" state, and the lack of a short-selling mechanism is considered an institutional factor for low-quality information disclosure [1].

In March 2010, the China Securities Regulatory Commission (CSRC) piloted the margin trading business, in which short selling through margin trading, as a short-selling mechanism, theoretically enhances market transparency by incentivizing investors to excavate negative information, thereby protecting investor interests [2]. However, in practice, frequent false negative news such as CITIC Securities' "Huge Loss Gate" has raised questions about the actual effect of the short-selling mechanism [3,4].

1.2 Research Significance

Theoretically, it supplements the localized research on the relationship between the short-selling mechanism and investor protection [4]. Practically, it provides case references for regulators to improve margin trading rules and helps optimize the investor protection system in the capital market [1].

With the continuous development of the capital market, the issue of investor protection has become increasingly prominent. As a form of short-selling mechanism, margin selling has gradually unfolded in the practice of China's capital market, but its impact on investor protection remains controversial [3]. This study aims to reveal the operational mechanism of margin selling in a weak legal risk environment and its actual effect on investor protection through an in-depth analysis of the "Huge Loss Gate" incident of CITIC Securities, providing a reference for regulatory authorities to formulate policies and promoting the

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healthy development of the capital market [2].

2. Literature Review

2.1 Theoretical Correlation between Short-Selling Mechanism and Investor Protection

Research by LLSV [1] indicates that the level of investor protection serves as the core variable in capital market development."

Margin selling can urge investors to explore the real information of enterprises through the reverse profit mechanism, restrict managerial opportunistic behavior, and theoretically constitute an important way of investor protection. , and the improvement of information disclosure quality is the key prerequisite for this process. Battalio et al. [2] argue that short selling should facilitate stock prices' return to a reasonable level.

2.2 Controversies and Deficiencies in Existing Research

Existing studies have differences: Certain studies suggest the short-selling mechanism enhances price discovery [3], while another part of the research shows that in regions with weak legal environments, short selling may be used to spread false information for profit (e.g., [4]). Domestic research on the empirical analysis of margin selling and investor protection is still insufficient, especially the lack of in-depth analysis of typical cases [4].

Domestic Research Status Domestic research on margin selling and investor protection started late and mostly focuses on the theoretical analysis level. Although some empirical studies have begun to pay attention to the market impact of margin selling in recent years, in-depth analysis of specific cases is still insufficient. This study aims to fill the gap in domestic empirical research in this field through the typical case of CITIC Securities' "Huge Loss Gate" incident, providing a new perspective and evidence for the localized research on the relationship between margin selling and investor protection.

2.2.1 Research on European and American markets

For example, Bris et al. (2007) studied short-selling mechanisms in 26 countries, showing that in nations with sound legal systems, short-selling more effectively fulfills price discovery functions, contrasting with China's weak legal environment [5].

2.2.2 Evidence from emerging markets

For instance, Aktas et al. (2016) examined the Indian market and validated the risk of collusion between short-selling and false information under lagging regulation, enhancing the generalizability of the paper's conclusions [6].

3. Research Design and Case Background

3.1 Research Methods

Using the case study method, combined with the event study method and cost-benefit analysis:

(1) Event sorting: Restore the timeline of CITIC Securities' "Huge Loss Gate" incident.

(2) Market reaction analysis: Evaluate the impact of the event based on stock price and trading volume data.

(3) Cost-benefit calculation: Quantify short-selling trading profits and violation costs, and explore the mechanism operation logic.

Data Collection and Processing: The data collection of this study mainly comes from public market data, official announcements of CITIC Securities, and CSRC investigation reports. Data processing includes the quantitative analysis of market reaction indicators such as stock prices and trading volumes, as well as the calculation of short-selling trading profits and violation costs. All data have been strictly screened and verified to ensure the accuracy and reliability of the analysis.

3.2 Case Background

On August 13-14, 2012, online media successively spread three pieces of negative information about CITIC Securities. At 13:48 on August 13, the Eastmoney.com stock forum claimed that "CITIC Securities suffered a huge loss of 2.9 billion yuan in overseas investment". At 14:40 on August 13, Weibo rumored that "the loss was 2.9 billion yuan and the chairman was taken away". At 13:07 on August 14, Weibo released that "a large number of employees of CLSA resigned". CITIC Securities successively issued clarification announcements on the evenings of August 13 and 14, denying the above rumors. On September 3, the CSRC found that all three pieces of information were false. The fabricators were individual investors, enterprise employees, and financial website reporters, respectively, with motives of venting investment loss emotions or attracting attention.

4. Case Analysis

4.1 Dissemination of Negative Information and Market Reaction

Table 1 Event Timeline and Stock Price Fluctuation

Time	Information Source	Information Content	CITIC Securities Stock Price Performance (Closing Price / Price Change)
August 9	/	/	12.24 yuan / +0.25%
August 13	Eastmoney Website	Overseas investment loss of 2.9 billion yuan	10.99 yuan / -9.10%, trading volume 175 million shares
August 14	Weibo	The chairman was taken away and CLSA resigned	10.81 yuan / -1.64%, trading volume 108 million shares
August 15	/	/	10.70 yuan / -1.02%
August 16	/	/	10.73 yuan / +0.28% (not returning to the pre - event level)

4.2 Characteristics of Market Reaction

Abnormal Fluctuation: On August 13, the stock price of CITIC Securities plummeted by 9.10% in a single day, and the trading volume increased by 5.4 times compared with the previous day. The industry index fell by 7.13% synchronously, indicating that the impact of false information on market sentiment is contagious. - Repair Lag: Although the company clarified in a timely manner, the stock price still fell by 12.3% compared with before the event on August 16, reflecting that the market's judgment on the authenticity of the information is delayed and the restoration of investor confidence is insufficient.

4.3 Measurement of Short-Selling Trading Profits and Violation Costs

4.3.1 Conservative Estimation of Short-Selling Profits Assumptions

The average short-selling price is the average closing price of the previous 3 days, which is 12.20 yuan. - The net short repayment volume is 1,696,900 shares in total from August 13 to 14 (data source: public information of the exchange). - The annual short-selling interest rate is calculated at the industry average of 10.19% in 2012, and the holding period is assumed to be 3 days. Measurement Results: - Profit 1 (the selling price on the day is equal to the repayment price): about 1.6 million yuan. - Profit 2 (the selling price on the day is equal to the closing price of the previous day): the profit can reach more than 2 million yuan.

4.3.2 Analysis of Violation Costs

According to Article 206 of the Securities Law, those who spread false information and have no illegal gains shall be fined up to 200,000 yuan. In the event, the three fabricators had no illegal gains, and the maximum total penalty was 600,000 yuan, which was only 37.5% of the minimum measured profit.

4.3.3 Expansion of event study method

Calculate the Cumulative Abnormal Return (CAR) of the "Huge Loss Gate" incident to quantify the impact of false information on stock prices (e.g., use the market model to compute CAR values over the [−5, +5] window period) [7].

4.3.4 Industry comparative data

Include stock price reactions of other brokerage firms during similar events to highlight the specificity and representativeness of the CITIC Securities case [4,6].

4.4 Logic of Mechanism Distortion in a Weak Legal Environment

4.4.1 Profit-Cost Imbalance

The short-selling profit is significantly higher than the violation cost, forming a reverse incentive of "bad money drives out good money", which urges speculators to profit through false information.

4.4.2 Information Transmission Failure

False negative news leads to short-term irrational decline in stock prices, deviating from the intrinsic value of the company. The margin selling business fails to play the theoretical price discovery function, but instead aggravates investors' losses.

4.4.3 Regulatory Lag

Although the CSRC found out the truth in the event, the punishment was insufficient, and the lack of a compensation mechanism for investors made it difficult to form an effective deterrent.

4.5 In-Depth Analysis of Mechanism Distortion Causes and Consequences

The mechanism distortion of margin selling in a weak legal risk environment not only stems from the imbal-

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ance between profits and costs but also relates to factors such as information asymmetry in the capital market and irrational investor structure. These factors work together, leading to margin selling failing to effectively play the price discovery function, but instead exacerbating market volatility and investor losses. In addition, mechanism distortion may also trigger the spread of market panic, further deteriorating the market environment and threatening the healthy development of the capital market.

5. Conclusions and Suggestions

5.1 Research Conclusions

5.1.1 Limited Mechanism Effect

In China's current legal environment, the theoretical expectation that margin selling improves investor protection has not been effectively realized, and the spread of false information leads to mechanism function distortion.

5.1.2 Highlighting of Core Contradictions

The imbalance between short-selling profits and violation costs is the root of the problem. Under weak legal constraints, the short-selling mechanism may be alienated into a speculative tool, harming the interests of small and medium investors.

5.1.3 Importance of Institutional Premise

The prerequisite for the short-selling mechanism to play a positive role is to improve the legal supervision system and strengthen the authenticity constraints of information disclosure.

5.2 Policy Suggestions

5.2.1 Improving the Legal Liability System

Improve the punishment intensity of the Securities Law for the spread of false information, link the fine amount to the illegal gains, and the maximum can be set to more than 5 times the profits [8].
Establish a class action system for investors, allowing investors who suffer losses to claim compensation from the fabricators of false information.
Graded punishment standards: Reference the U.S. Dodd-Frank Act to propose setting fines as a proportion of the illegal amount (e.g., 1–5 times the illegal gains) rather than fixed amounts [4].
Graded punishment standards: In addition to punitive measures, technological innovation can enhance regulatory efficiency
References the U.S. Dodd-Frank Act to propose setting fines as a proportion of the illegal amount (e.g., 1–5 times the illegal gains) rather than fixed amounts.
Regulatory technological innovation: Introduce Natural Language Processing (NLP) technology to monitor false information on social media, enabling real-time early warning of abnormal information and improving regulatory efficiency [4].

5.2.2 Strengthening the Supervision of Margin Selling Business

Establish a linkage monitoring mechanism between short-selling transactions and information disclosure, and carry out simultaneous verification of abnormal short-selling transactions and media information dissemination.
- Require short-selling institutions to disclose position information, increase transaction transparency, and suppress malicious short-selling behavior.

5.2.3 Optimizing the Investor Protection Mechanism

Promote the expansion of the investor protection fund in the securities market and establish a rapid compensation mechanism for losses from false information. Strengthen investor education, improve the ability to identify false information, and reduce the risk of irrational follow-the-crowd trading.

5.2.4 Strengthening Investor Education and Market Culture Construction

In addition to improving the legal liability system and strengthening the supervision of margin selling, strengthening investor education and market culture construction is also an important way to improve the level of investor protection. Various forms of educational activities should be carried out to improve investors' cognition and understanding of margin selling and the capital market, enhance their risk awareness and self-protection capabilities. At the same time, we should actively advocate an honest and rational market culture, create a good market environment, and promote the long-term stable development of the capital market.

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