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Regulatory Uncertainty and Market Liquidity: The 2008 Short Sale Ban's Impact on Equity Option Markets

Robert Battalio

Paul Schultz

Abstract

We examine how the September 2008 short sale restrictions and the accompanying confusion and regulatory uncertainty impacted equity option markets. We find that the short sale ban is associated with dramatically increased bid-ask spreads for options on banned stocks. In addition, synthetic share prices for banned stocks become significantly lower than actual share prices during the ban. We find similar results for synthetic share prices of hard-to-borrow stocks, suggesting that the dislocation in actual and synthetic share prices is attributable to the increased hedging costs for options on banned stocks during the short sale ban.

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