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Short-Selling Transactions in the Indonesian Capital Market: A Theoretical and Practical Perspective

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ABSTRACT

Short selling transactions are a common practice among investors, clients, and other parties involved in capital market activities in Indonesia. The practice of short selling in Indonesia is specifically regulated under Bapepam-LK Regulation No. V.D.6 and Indonesia Stock Exchange Regulation No. II-H. However, challenges arise in both theory and practice, often creating uncertainty and deviating from the theoretical basis of the permissible short selling transactions. The findings reveal that short selling transactions are permissible under the provisions of the Third Book of the Indonesian Civil Code and the principle of freedom of contract, as these transactions are fundamentally considered as sales agreements in theory. Nonetheless, in practice, such transactions frequently disadvantage investors, clients, and other stakeholders due to the volatile profit and loss dynamics in the capital market. To address these issues, the implementation of C-BEST, a public facility, plays a crucial role in preventing violations and minimizing the risk of losses in the capital market for all parties involved.

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INTRODUCTION

The capital market serves as a crucial source of funding for business actors seeking financing to enhance their working capital. This additional capital is utilized by investors and the broader community for various economic purposes (Susanto, et al. 2019). Moreover, the activities of the capital market significantly contribute to national economic growth, as evidenced by increased transactions and trading activities on the stock exchange (Hajayanti, et al. 2024). In the context of modern technological advancements, it is almost inconceivable to achieve robust and well-organized economic development without a functional and efficient capital market (Junaedi & Salistia, 2020).

Indonesia, as a developing country, recognizes the critical role of the capital market in its economic growth. Acknowledging this, Indonesia has established specific regulations governing the capital market, as outlined in Law Number 8 of 1995 on Capital Market. This regulation aims to provide legal certainty, utility, and fairness for business actors, investors, and the general public who utilize the capital market to secure additional capital or support their respective economic development endeavors (Hardi, 2020). The enactment of this law has instilled confidence among all stakeholders involved in the capital market, ensuring a more secure and structured environment for economic activities since its implementation. The capital market plays a strategic role in Indonesia, particularly in supporting national development (Yusrina, et al., 2023). It serves as a source of financing for businesses and provides an investment platform for the public. Through the capital market, young people can explore and identify funding opportunities for various business ventures, enabling them to acquire securities or ownership stakes in the market (San & Rohana, 2021).

As a rule-of-law state, Indonesia ensures legal certainty in the regulation of its capital markets, guided by the Capital Market Law as its legal foundation. Additionally, the country enforces specific regulations through key institutions such as the Capital Market and Financial Institution Supervisory Agency, the Indonesia Stock Exchange, and the Financial Services Authority (Suhardini, 2021). These institutions are specifically established to oversee the operations of the capital market in Indonesia. Notably, the OJK is entrusted with regulatory and

supervisory functions related to capital market activities, a role previously held by BAPEPAM-LK (Toha & Manaku, 2019).

In theory, the capital market is divided into two segments: the primary market and the secondary market. The primary market is the initial platform where a corporation's securities are offered to the public for a specific period before being listed on the secondary market. The secondary market, on the other hand, facilitates trading activities after the securities are listed (Jamil & Hayati, 2021). It serves as the central hub of capital market activities, characterized by a high volume of transactions and trading operations. The secondary market plays a pivotal role as the primary venue for trading, marking the conclusion of initial public offerings and the beginning of broader securities exchange activities (Junaedi, et al., 2023).

The concept of "securities" is explicitly defined in the Indonesian Capital Market Law, which classifies securities into two main categories: equity-based securities, such as shares, and debt-based securities, such as bonds. Among these categories, equity securities (shares) are the most commonly traded instruments in the capital market (Kapoh, 2019). Shares represent evidence of an individual's ownership in a company, with the owners referred to as shareholders. The term "transaction" in the capital market is interpreted similarly to a "contract" under civil law, with theories and fundamental principles of contract law forming the basis for analyzing capital market transactions (Fathoni, 2021). These transactions are classified as *obligatory agreements*, which are agreements of sale and purchase that establish rights and obligations for the involved parties. However, ownership rights are not immediately transferred; they are contingent upon delivery or *levering*. Levering, or delivery, refers to the transfer of ownership of securities from the rightful owner to another party, resulting in the latter becoming the legal owner of the securities (Selasi, 2020).

According to Article 1, Section 1 of BAPEPAM V.D.6, which regulates the financing of securities transactions by securities companies for clients and mutual transactions among securities companies, short selling is defined as the sale of securities that the seller does not own at the time of the transaction (Hanifah, 2022). Short sellers typically leverage the T+3 settlement period—where transactions are settled three days after execution—to fulfill delivery obligations by repurchasing the sold securities. Under civil law, securities involved in capital market

transactions are considered *future objects*, as their delivery occurs on the third day post-transaction. This arrangement motivates investors to engage in short selling, utilizing the three-day settlement window to execute their strategies (Putri, et al., 2022). However, short selling poses the risk of failure to deliver in paperless trading, which occurs when brokerage firms sell securities without sufficient stock in their securities accounts. Such failures can result in significant issues, given the high costs associated with executing securities sales in this manner. These challenges highlight the critical need for regulatory oversight and careful planning to manage the risks inherent in short selling practices in the capital market (Haridhi, 2020).

Thus, as explained above, short selling transactions in the Indonesian capital market can pose significant challenges for investors if not conducted properly in accordance with the applicable regulations. This study employs a normative legal research method. In line with this approach, data analysis relies on references from journals, books, and relevant legislative frameworks. The data collection method is primarily library research, while data analysis is conducted using a qualitative approach. Consequently, this research aims to provide reliable data and in-depth analysis regarding the issues discussed, offering a comprehensive and accountable understanding of the subject matter.

METHOD

This study employs a normative legal research methodology to analyze the legal framework governing short-selling transactions in the Indonesian capital market. A statutory approach is used to examine relevant regulations, including Law Number 8 of 1995 on Capital Market, Financial Services Authority (OJK) regulations, and Indonesia Stock Exchange (IDX) trading rules (Disemadi, 2022). Additionally, a conceptual approach is applied to explore theoretical foundations of short-selling, focusing on its economic impact, risk management, and regulatory challenges. The research relies on secondary data, including primary legal sources such as statutes and government regulations, secondary sources such as books, journal articles, and legal commentaries, and tertiary sources like legal encyclopedias and financial reports. Document analysis is the primary data collection method, with legal texts and academic literature critically examined to assess regulatory effectiveness (Tan, 2021).

The analysis involves three main approaches: legal interpretation, using grammatical, systematic, and teleological methods to evaluate statutory provisions; comparative analysis, assessing Indonesia's short-selling regulations against those in jurisdictions like the U.S. or Singapore; and doctrinal analysis, exploring legal, economic, and ethical dimensions of short-selling (Disemadi, 2022). This study aims to clarify Indonesia's legal framework for short-selling, assess whether existing regulations ensure market stability and investor protection, and provide recommendations for regulatory improvements. By integrating legal and economic perspectives, this research contributes to academic discourse and offers valuable insights for policymakers in refining Indonesia's capital market regulations (Nafisatur, 2024).

DISCUSSION AND ANALYSIS

The legal framework governing short-selling transactions in the Indonesian capital market, and the extent to which these regulations align with global capital market practices.

Indonesia has established comprehensive regulations on capital market law concerning short selling transactions, as outlined in BAPEPAM V.D.6. These regulations govern short selling activities conducted by clients and facilitated by securities companies, allowing such transactions under specific conditions (Kiandi, 2019). Securities companies are obligated to meet the requirements for financing dispute resolutions related to securities. Additionally, only eligible clients who fulfill the stipulated criteria are permitted to engage in short selling transactions. Both securities companies and clients must formalize their financing arrangements through agreements that include standardized clauses as mandated by Article 4. Furthermore, securities companies are required to conduct thorough due diligence on client eligibility, ensuring compliance with initial margin and collateral requirements (Al-Hamidah, et al., 2025). They must also enter into securities lending agreements to support the financing of client short selling activities. Importantly, the regulatory framework restricts the facilitation of short selling transactions exclusively to securities companies. These provisions aim to promote a responsible and well-regulated approach to short selling within Indonesia's capital market system (Adawiyah & Najmudin, 2011).

The parties involved in short selling transactions as outlined in BAPEPAM Regulation V.D.6 consist of investors or clients, securities companies, and the Indonesia Stock Exchange (IDX). Investors are required to fulfill specific conditions to gain the right to participate as short sellers. These include maintaining a securities account with a securities company, opening a financing account for short selling transactions, and providing collateral of at least 150% of the transaction value. If a client fails to meet these obligations, the securities company is required to purchase the securities sold through short selling by the fourth business day, ensuring compliance with the regulations (Satrio, 2022).

Securities companies are primarily responsible for ensuring compliance with the rights and obligations of investors or clients in securities transactions, including short selling. To facilitate such transactions, securities companies must meet several pre-transaction requirements, including obtaining a business license from the Financial Services Authority (OJK) to operate as an intermediary in securities trading and securing approval from the Stock Exchange to conduct short selling transactions (Valentio, 2020). Additionally, they must adhere to post-transaction rules, such as ensuring that the financing value provided to clients does not exceed 50% of the collateral value. The Indonesia Stock Exchange (IDX), as the provider of systems and infrastructure for securities trading, is mandated by Article 2 of BAPEPAM Regulation V.D.6 to establish rules defining eligible securities for financing by securities companies, which will then serve as collateral for short selling transactions. The IDX must also develop trading systems to facilitate short selling transactions. Over time, the IDX has introduced new regulations to address compliance issues. For example, in 2014, violations by 12 securities companies led to failed deliveries, prompting the temporary suspension of short selling transactions. This incident resulted in additional rules, such as the verification of funds or securities adequacy, the review of transaction history, and the implementation of customer due diligence for foreign financial market participants (Omardani & lestari, 2024).

In 2009, the short selling facility was reintroduced with updated policies to enhance market integrity. These policies included revised regulations on sub-accounts under Bapepam Regulation II.C.7, which improved the Central Securities Depository (KSEI) system to provide better investment protection through the C-BEST system. Another policy was the implementation of Single Investor Identification (SID) based on the Chairman of Bapepam's

Decree No. KEP-327-BL-2012, requiring all investors to have a unique identification number for greater transparency and traceability in the capital market. These measures aim to strengthen market integrity and ensure compliance with both domestic and international financial regulations (Saifulloh, 2020).

If we carefully analyze the explanation above and consider specific regulations established to address the recurring issues, it becomes evident that these rules serve as mechanisms to prevent violations, particularly those frequently observed in the stock market, such as short selling. These measures aim to ensure that violations not adequately covered by existing regulations can be effectively addressed through the tailored facilities and provisions designed for this purpose. In this context, Book III of the Indonesian Civil Code regulates short selling by equating it with issues of contractual agreements. A short selling agreement arises when parties bind themselves through a mutual commitment to perform certain actions. The principle of freedom of contract, as stipulated in Article 1338(1) of the Civil Code, asserts that agreements lawfully entered into by the parties are binding and carry the force of law for those who execute them.

The principle of freedom of contract is an inherent individual right, enabling parties to create and execute agreements. Reflecting the open nature of the Civil Code, it permits the formation of contracts beyond those explicitly regulated within the Code, provided they adhere to the fundamental principles and validity requirements of a lawful agreement. Failure to comply with these legal prerequisites may render the contract null and void. Therefore, while the Civil Code allows the formation of contracts outside its explicit provisions, parties must ensure that all agreements respect its binding legal framework to avoid nullification (Abubakar & Handayani, 2019).

Article 1320 of the Indonesian Civil Code serves as a cornerstone and guideline for parties engaging in agreements or contracts. While freedom of contract is a fundamental principle, it is not without limitations; it must adhere to the provisions outlined in this article. The principle of freedom of contract also underpins the practice of short selling in capital markets and provides a legal foundation for securities companies to undertake contractual arrangements in its implementation. Opening an account is the initial step for conducting securities transactions on the Indonesian stock exchange (Umar, et al., 2024). However, if an investor intends to engage in short selling, they must first enter into a securities transaction financing agreement as a form of

guarantee for the transaction. The short selling transaction itself is incorporated into the agreement, reflecting the exercise of freedom of contract as safeguarded by Book III of the Indonesian Civil Code. This agreement delineates the rights and obligations of the parties involved, providing legal protection and a clear framework for the agreed-upon terms (Febrina, 2022).

Short selling transactions generally resemble standard stock sale agreements. However, the distinction lies in the nature of the transaction: the seller does not possess the stock being sold. To fulfill the obligations stipulated in the agreement, the short seller must procure the stocks from the market. If the required securities are unavailable, the short seller may utilize borrowing facilities provided by PT KPEI (Indonesia Clearing and Guarantee Corporation). PT KPEI facilitates stock loans to short sellers, resulting in a series of interconnected events, including transactions between the seller and a securities company, between securities companies, and/or with a custodian bank or PT KPEI itself. This structure ensures that short selling transactions are executed within a legally regulated framework, balancing the principles of freedom of contract with the need for legal certainty and protection for all parties involved.

Short selling is a strategy employed by investors to generate profit in declining market conditions. This practice is often cited as a contributing factor to the destabilization of market values, sometimes leading to its characterization as an illegal or unethical transaction by certain stakeholders. In practice, investors typically engage in short selling by borrowing shares before initiating a sell position (Mulyadi & Rusydi, 2017). The implementation of short selling presents both advantages and disadvantages for those involved. One of the primary benefits is that short selling ensures stock prices align with their fundamental values. Theoretically, when stocks are in a "long" or static position, investors may seize the opportunity to engage in short selling to capitalize on potential profits. However, the risks associated with short selling are significant. Investors face the possibility of substantial losses, as the potential for profit and loss in short selling is inherently asymmetrical. This imbalance underscores the high-risk nature of the practice, making it a controversial yet integral aspect of market dynamics (Fadhilah, 2019).

Indonesia has established regulations regarding capital market law that govern short selling transactions. Based on BAPEPAM Regulation V.D.6, these regulations apply to short selling transactions conducted by both clients and securities companies. Although short selling is

permitted, it must adhere to specific conditions to ensure compliance and market stability. Securities companies are required to meet financing requirements for securities dispute resolution and must verify the eligibility of clients before allowing them to engage in short selling transactions. Only qualified clients are permitted to participate, and both securities companies and clients must enter into a financing agreement that includes standard clauses as stipulated in Article 4. Additionally, securities companies must conduct due diligence on clients' financial standing in accordance with initial and margin collateral requirements. To facilitate short selling transactions, securities companies must also establish securities lending agreements. Furthermore, the execution of short selling transactions is strictly limited to securities companies that meet the regulatory requirements.

Short selling transactions in Indonesia involve multiple key stakeholders, each with specific roles and responsibilities to ensure compliance with financial regulations. Investors, as primary participants, must fulfill stringent requirements to engage in short selling, including maintaining a securities account with an authorized brokerage firm, opening a dedicated short selling financing account, and providing a minimum collateral of 150% of the transaction value at the time of execution (Sabirin & Herfian, 2021). Failure to meet these obligations results in mandatory buyback by the securities company on the fourth trading day, ensuring transactional integrity. Securities companies serve as the main regulatory enforcers in short selling transactions, bearing the responsibility of facilitating and supervising investor activities. Under BAPEPAM V.D.6, IDX is responsible for defining eligible securities for short selling and ensuring an efficient trading system to support such transactions. However, historical non-compliance cases, such as the failure of twelve securities companies to meet delivery obligations in 2014, prompted the implementation of stricter enforcement measures. These include mandatory verification of client funds or securities (*V.D.3, Article 4(b)(2)*), transaction history assessments (*V.D.6, Article 3(a)*), and rigorous *Know Your Customer (KYC)* principles for international market participants (*V.D.6, Article 9(g)*).

Recognizing the need for enhanced governance, the IDX reintroduced short selling facilities in 2009, accompanied by pivotal regulatory advancements. This included the revision of sub-securities account regulations (*Bapepam Regulation No. II.C.7*), enabling enhanced investor protection through the C-BEST system managed by KSEI. Additionally, the adoption of Single

Investor Identification (SID) under *Bapepam Chairman's Decree No. KEP-327/BL/2012* further strengthened regulatory oversight by requiring unique investor identification numbers for all market participants. From an academic and regulatory standpoint, the evolution of short selling regulations underscores the critical importance of compliance and market stability. By continuously refining its regulatory framework, IDX not only mitigates risks but also fosters investor confidence in the capital market. These stringent measures serve as a safeguard against market manipulation while promoting responsible and sustainable trading practices in Indonesia's financial sector (Rusdiana & Amam, 2021).

Theoretical approaches and best practices applied to mitigate emerging risks

The primary Short selling, as regulated in Book III of the Indonesian Civil Code, is legally recognized as a contractual agreement, wherein parties bind themselves to perform specific obligations. The principle of freedom of contract, as enshrined in Article 1338(1) of the Civil Code, affirms that agreements voluntarily made by the parties have the force of law, thereby ensuring their enforceability. This principle grants individuals the autonomy to engage in legally binding contracts, reflecting the Civil Code's inherently open nature, which allows for agreements beyond those explicitly stipulated within its provisions. Despite this flexibility, contractual freedom is not absolute. Parties must strictly adhere to the legal principles and validity requirements of a contract, as outlined in the Civil Code. Failure to comply with these fundamental legal norms may result in an agreement being declared null and void, underscoring the necessity of legal conformity even for contracts formed outside the direct scope of Book III. Thus, while the legal framework permits innovation in contractual arrangements, it also imposes safeguards to ensure their legitimacy and enforceability. In this context, Article 1320 of the Civil Code serves as a foundational guideline for parties entering contractual obligations, reinforcing that while contractual freedom exists, it must operate within defined legal boundaries. This principle is particularly crucial in the capital market, where short selling relies on robust contractual structures to regulate its execution. Securities companies must ensure that their contractual frameworks uphold legal standards, thereby maintaining market integrity and fostering investor confidence. Upholding these legal principles not only safeguards the enforceability of short-selling agreements but also strengthens regulatory compliance and economic stability.

The act of opening an account serves as an initial step in initiating securities transactions on the Indonesian stock exchange. However, if an investor intends to engage in short selling activities, they must enter into a securities transaction settlement financing agreement as a form of guarantee for the transaction being carried out. Short selling transactions are included in the agreement as an implementation of the freedom of contract principle guaranteed under Book Three of the Indonesian Civil Code (Fakhriah, 2015). This agreement outlines the rights and obligations of the parties involved in short selling transactions, ensuring legal protection and mutual consent between the contracting parties. In general, short selling transactions resemble regular stock purchase agreements. However, the key difference lies in the fact that, in a short selling transaction, the seller does not own the shares at the time of sale. To fulfill their obligations under the agreement, the short seller must source the shares from the market. If the securities are unavailable in the market, the short seller may utilize the borrowing facility provided by PT KPEI. In this context, KPEI facilitates stock lending to the short seller, triggering a series of transactions involving the seller, a securities company, and subsequently, interactions between securities companies, custodian banks, or PT KPEI itself (Sari & Ismawati, 2022).

Short selling is a strategy employed by investors to generate profits in a declining market. This practice involves selling borrowed shares with the expectation of repurchasing them at a lower price. However, short selling is often criticized for its potential to accelerate market downturns, leading some to perceive it as an unethical or even illegal trading activity. In practice, investors engaging in short selling typically borrow shares before executing a sell position. Short selling presents both advantages and risks for market participants (Ali et al., 2024). One key advantage is its role in ensuring that stock prices reflect their fundamental value, contributing to market efficiency. Theoretically, when a stock remains in a long position or is stagnant, investors may engage in short selling to capitalize on price fluctuations. However, the risks associated with short selling can be substantial, as potential losses are unlimited if stock prices rise unexpectedly. This inherent imbalance between profit potential and risk exposure makes short selling a highly speculative and controversial trading strategy (Dharmasisya, 2023).

Short-selling is widely recognized as a high-risk financial strategy in capital markets, allowing investors to profit from declining stock prices. Unlike traditional long-position investments, where investors purchase stocks in anticipation of price appreciation, short-selling

involves borrowing shares and selling them at the current market price, with the expectation of repurchasing them later at a lower price. If the stock price declines, the short-seller profits from the difference; however, if the stock price rises, potential losses are theoretically unlimited. This asymmetry of risk makes short-selling inherently volatile and necessitates stringent risk mitigation measures. Given its speculative nature, short-selling can significantly influence market stability, liquidity, and investor confidence (Safriani, 2016). It has been associated with both market corrections and, in some cases, market crashes due to excessive short positions exacerbating downward price movements. Therefore, implementing theoretical frameworks and regulatory best practices is crucial to managing the risks associated with short-selling transactions. From a theoretical standpoint, risk mitigation in short-selling aligns with contract law principles, particularly the freedom of contract as outlined in the Indonesian Civil Code. These legal provisions govern the enforceability of short-selling agreements and ensure that transactions adhere to fair and transparent contractual obligations (Effendi, 2020). Additionally, financial theories, such as the Efficient Market Hypothesis (EMH), emphasize that short-selling contributes to market efficiency by facilitating price discovery. However, unchecked speculative short-selling can lead to information asymmetry and market manipulation, necessitating regulatory oversight (Winarto, 2020).

Short-selling transactions pose significant financial and legal risks, requiring a strong theoretical framework for effective risk management. Legally, short-selling in Indonesia follows the principle of freedom of contract under Book III of civil code, granting parties autonomy in agreements, provided they meet the conditions in Article 1320. However, enforceability remains a challenge due to complex contractual relationships like margin lending and guarantee agreements, highlighting the need for regulatory safeguards. Financially, short-selling aligns with market efficiency theory and arbitrage principles. The efficient market hypothesis (EMH) suggests that short-selling corrects overvalued stocks, enhancing price discovery. However, excessive short-selling risks price manipulation and market instability. Arbitrage theory highlights profit opportunities from price discrepancies, yet market volatility can lead to significant losses for short sellers (Fauzi, 2021). Additionally, information asymmetry and moral hazard exacerbate short-selling risks. Unequal access to market information may lead to distortions, insider trading, and reduced investor confidence. Meanwhile, moral hazard occurs when traders engage in speculative short-selling without facing full consequences, threatening

market stability. To mitigate these risks, regulators enforce disclosure requirements, short-selling restrictions, and circuit breakers. By integrating legal and financial theories, effective risk mitigation strategies can balance market efficiency with investor protection, ensuring a more stable and transparent capital market (Sinaga et al., 2023).

Market surveillance and transparency are crucial in mitigating short-selling risks, preventing market manipulation, and enhancing investor confidence. Regulatory bodies, such as Indonesia's Financial Services Authority (OJK), mandate disclosure requirements to ensure short-selling activities are properly monitored. By requiring investors to report significant short positions, these regulations help assess market trends and curb excessive speculation. Similar measures by the U.S. Securities and Exchange Commission (SEC) reinforce global best practices in maintaining market integrity (Sunaryo & Utomo, 2023). Real-time monitoring and reporting systems further enhance transparency by detecting irregular trading patterns, such as naked short selling. The Indonesia Stock Exchange (BEI) employs advanced surveillance tools, including automated alerts and algorithmic trading detection, to prevent market abuse. Comparable frameworks, such as those implemented by the European Securities and Markets Authority (ESMA), demonstrate the increasing reliance on digital oversight to uphold market stability. Regulatory interventions have proven essential in mitigating financial risks. During the 2008 financial crisis, Indonesia, like many other nations, temporarily suspended short-selling to prevent excessive market downturns. Recent regulatory updates have reinforced stricter margin requirements and disclosure rules. Similarly, Hong Kong's Securities and Futures Commission (SFC) enforces a centralized reporting system to ensure fair market conditions. These measures highlight the necessity of proactive oversight in fostering financial stability and investor protection (Ferdiansyah et al., 2024).

CONCLUSION

The concept and practice of short selling transactions in Indonesia's capital market often diverge in interpretation, making it a strategic option for generating profit under specific stock conditions. Theoretically, short selling aligns with the principles outlined in Book III of the Indonesian Civil Code, particularly the principle of freedom of contract, which is reflected in the guarantee agreements underlying short selling transactions. However, the theoretical application

of contractual freedom in short selling must also be examined in light of Article 1320 of the Civil Code, which stipulates the essential requirements for a valid contract. This raises challenges in defining an ideal short selling transaction in accordance with its intended purpose. In practice, Indonesia's stock exchange has implemented specific regulations governing short selling to mitigate risks and prevent detrimental consequences for investors and market participants. These regulations are primarily set forth in Bapepam Regulation No. V.D.6 on Securities Transaction Financing by Securities Companies for Clients and Short Selling Transactions, further refined through Bapepam Regulation No. II.C.7 on Sub-Securities Accounts at Custodian and Settlement Institutions, alongside other relevant regulatory frameworks. These measures aim to safeguard market stability and protect stakeholders from potential losses associated with short selling transactions.

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