

Crackdown on 'naked short-selling' intensifies

By Brooke Masters in New York

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The crackdown on 'naked short-selling' intensified on Wednesday as the Securities and Exchange Commission brought its first enforcement cases against the practice – betting that a stock will fall while failing to borrow the underlying shares.

In its filing, the SEC said options traders at Hazan Capital Management and TJM Proprietary Trading of Chicago had improperly claimed to be exempt from rules requiring them to locate the stocks they had been shorting, and then had used complicated options transactions to avoid settling their trades as required.

The firms and their employees have agreed to pay a total of \$4.7m in fines, but neither admitted nor denied liability.

A lawyer for HCM said the firm had concluded that the costs of fighting the SEC charges would be equivalent to paying the penalty.

These cases may be just the tip of the iceberg. Wednesday's action "is part of a larger effort and there are a number of other firms we are investigating", said Scott Friestad, associate director of enforcement.

Short-selling has come under regulatory scrutiny in the aftermath of the financial crisis, with some critics saying it exacerbated the troubles of weak banks. US, UK and European Union regulators have all proposed increased disclosure of short positions.

In the US, naked short-selling has drawn particular opprobrium and the SEC recently sought to weed out the practice by reducing the timeframe for locating stock to cover a short trade.

Brokers must now close out positions within four days instead of 13.

"Naked short selling potentially dilutes shareholders influence and potentially creates a misleading impression of the market," said Leslie Kazon, the SEC assistant regional director on the HCM case.

The two cases predate the tighter rules. HCM's trades occurred from 2005 to 2007 and TJM traded in 2007.

In both cases, the SEC said, the traders had become involved with naked short-selling through transactions known as "reverse conversions", in which a trader uses options to replicate a long position while simultaneously hedging himself by selling the same stock short.

Borrowing stock to cover the short position can be expensive and cut into returns.

TJM and HCM claimed to be acting as marketmakers.

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