

Chamber Seeks Tougher Naked Short-Selling Rules

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The U.S. Chamber of Commerce has called on federal securities regulators to take extra measures to crack down on improper naked short-selling practices.

The chamber, which represents more than 3 million businesses and organizations, sent a letter to the U.S. Securities and Exchange Commission on Thursday that said fraudulent naked short sales continue to pose significant problems for small and mid-sized firms and their shareholders.

While the chamber hailed the SEC for its efforts to rein in the improper selling, it recommended that more needed to be done to address the issue.

“These practices will continue to plague smaller and mid-size companies if the SEC does not take action to regulate more tightly the preborrow requirements and increase transparency and disclosure regarding the practice of short-selling,” the chamber wrote.

The business group suggested that short sellers of threshold stocks, or securities that are difficult to borrow, should possess the stock in question or at least have entered into a legitimate contract to borrow the stock prior to a short sale.

Another recommendation called for “increased transparency,” in which the SEC should provide issuers with daily aggregate reports of borrowed stocks that were not delivered.

The chamber said some companies are limited in redressing the situation due to the lack of transparency regarding the failures that are affecting their stock.

The chamber also proposed that institutional investors should disclose short positions so that the SEC can include them in reports it already files on long positions.

“This will provide issuers and investors with a greater understanding of trading activity without compromising the proprietary trading strategies of institutional investors,” the chamber noted. Short-selling takes place when investors borrow stock they hope will decline in value so they can return it to brokers and keep the difference. Short-selling itself is considered by many to be blatant manipulation, but illegal naked short-selling takes place when brokers put up IOUs they can't honor.

The SEC took steps to curtail naked short-selling with a set of rules called Regulation SHO, which went into effect in 2005.

Some critics found that the rules did not go far enough because the SEC exempted delivery failures that existed before a company became a threshold security, forcing brokers to buy in some positions on threshold-listed securities that were made before the companies made the list.

This year, the SEC voted to get rid of “grandfather” safeguards for previous delivery failures, beginning on Oct. 15, and recommended eliminating the options market maker exception—two moves that were backed by the chamber. But the chamber said the SEC needed further reforms to eradicate the problems.

“Unfortunately, we believe that the proposed reforms do not extend far enough to resolve the issues related to fraudulent naked short selling,” the chamber wrote. “We remain convinced that serious settlement failures will persist and companies will remain on the threshold list for too long if the SEC does not implement additional reforms.”

Since Regulation SHO took effect in January 2005, a slew of companies and individual brokers have come under fire for potential market manipulation.

The Vonage Holdings Corp. initial public offering came under attack by the New York Stock Exchange in June 2006, with the agency's regulatory unit sending a letter to brokerage firms inquiring about possible short sales of Vonage shares.

In May 2006, the SEC subpoenaed online retailer Overstock.com as part of an ongoing probe into allegations of naked short-selling.

And a month earlier, hedge fund Quark Fund LLC sued a slew of top brokerage firms, including financial services powerhouses Bear Stearns Companies Inc., Citigroup Inc., and Goldman Sachs & Co., charging them with selling stock they hadn't even borrowed, leaving customers with fees and interest charges for loans that never existed.

Earlier in 2006, the state of Utah joined the fray when state legislators passed a bill allowing Utah-based companies to fine brokerages \$10,000 a day if they fail to follow the new short-selling rules.

Central to the law is the requirement that brokers alert the state's securities regulator within 24 hours about how many borrowed shares its short sellers won't be able to deliver as promised.

--Additional reporting by Erin Marie Daly

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