

SEC urged to do more to curb naked short selling

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By Rachelle Younglai

WASHINGTON, Dec 9 (Reuters) - U.S. securities regulators need to do more to crack down on abusive naked short selling -- a type of trading blamed for contributing to the free-fall in financial stocks -- former and current regulators said on Tuesday.

Amid volatile market conditions, the Securities and Exchange Commission adopted a number of rules to rein in those who profit illegally from stock declines.

Making bearish bets on stocks is a legitimate investment strategy but the SEC's rules are designed to weed out abusive practices, such as investors' failure to deliver stock by settlement date.

Short sellers arrange to borrow shares they consider overvalued in hopes of repaying the loan for less and profiting from the difference. A naked short sale occurs when an investor sells stock that has not yet been borrowed, which can distort markets.

Former SEC Chairman Harvey Pitt praised the SEC for taking constructive steps but said the agency has not done enough.

"Naked shorting is a situation in which someone is gambling but they have no skin in the game. They are not required to make any effort to deliver the shares," said Pitt, one of the panelists speaking at a "Coalition Against Market Manipulation" event in Washington.

The SEC tightened up its rules this year and required short sellers to deliver securities three trading days after shorting the stock.

Rex Staples, general counsel for an association of state securities administrators, said the states are trying to eliminate the problem, but said "this seems to be a solution that the commission is best-equipped to solve."

"States are ready to act, but we are throwing our support behind the federal regulator at this point," said Staples, general counsel for the North American Securities Administrators Association.

Pitt and other panelists said the SEC needed to do more to eliminate ambiguity in its rules.

For example, investors are required to locate shares before shorting them. However, SEC rules require broker dealers to have "reasonable grounds" to believe that the security can be borrowed so that it can be delivered by settlement date. Critics say the language is vague.

"If you want to sell short any security, you should have a legally enforceable right to deliver stock on day of settlement. It's unambiguous, it doesn't leave any wiggle room," said Pitt.

Jonathan Johnson, president of web retailer Overstock.com Inc (OSTK.O: [Quote](#), [Profile](#), [Research](#), [Stock Buzz](#)), agreed and said the SEC should require investors to borrow the stock ahead of time to prevent manipulation between the trading day and delivery date. Overstock is known for its vigorous war against naked short selling and has brought lawsuits against major U.S. brokerages. (Reporting by Rachelle Younglai, editing by Matthew Lewis)

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