September 18, 2008

Bold SEC Action is Needed

Last evening, the SEC announced two initiatives to address short selling abuses. First, Chairman Cox announced that he was asking the SEC, on an emergency basis, to adopt a new disclosure rule that would require hedge funds and other large investors to disclose their short positions in order to provide transparency in short selling. Specifically, managers with more than $100 million invested in securities would be required to promptly begin public reporting of their daily short positions. The SEC also announced that its Enforcement Division would be subpoenaing from "significant hedge funds and other institutional traders" information, including e-mails, concerning their past trading positions in specific securities.

The SEC's most recent announcements, while important steps, do not go nearly far enough. Immediate and stronger SEC action is necessary.

The SEC needs to consider the following measures:

- The SEC should use its emergency powers to halt short selling in the securities of financial services firms and banks for a 90-day period. This action is consistent with the action taken by the FSA today. The SEC needs to do this now. The FSA announced that it is prohibiting the "active creation or increase of any short positions" in publicly quoted financial companies from this evening until January 16, 2009 (although the ban will be reviewed after 30 days). The FSA also announced that a complete review of the rules on short selling will be published in January, 2009. Hector Sants, chief executive of the FSA, said:

  > "While we still regard short-selling as a legitimate investment technique in normal market conditions, the current extreme circumstances have given rise to disorderly markets. As a result, we have taken this decisive action, after careful consideration, to protect the fundamental integrity and quality of markets and to guard against further instability in the financial sector."

- The new disclosure rule the SEC is considering should be modeled after Regulation 13D and the SEC should issue the rule immediately. It should require hedge funds and other institutional investors to publicly report their daily short positions if those positions exceed ¼ of 1% of the outstanding shares of a public company and should also disclose publicly whether the short sellers have any oral or written contract, arrangement, understanding or relationship (legal or otherwise) with respect to those securities. The short sellers also should be required to report to the SEC on a next-day basis if they fail to deliver securities by settlement date.

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- It has been publicly reported that California Public Employees' Retirement System (CalPERS) will no longer lend shares of Goldman Sachs and Morgan Stanley. CalPERS stated that "[w]e don't want to inadvertently contribute to the instability of these companies or the market." The SEC should undertake a voluntary initiative among lenders of securities pursuant to which the lenders would agree for 90 days not to lend securities of any financial services firms or banks.

- The SEC, in cooperation with the Federal Reserve Board, the FSA and the Treasury Department, should undertake a 60-day comprehensive review of the credit default swap market in order to determine what rules and regulations are needed and whether there has been any improper or violative conduct by those engaged in CDS transactions. In this market crisis, it is unacceptable that there is no regulatory structure to oversee the extraordinarily important CDS market sector. At the same time, the International Swap and Derivatives Association should seek to have its members voluntarily forebear from writing any new CDS's except if they own the underlying security.

- As we have previously suggested, the SEC, under its emergency powers, should immediately re-impose the "Uptick Rule".

Consideration of these additional steps are vital to restoring investor confidence in the fairness and integrity of the markets and to address the crisis of confidence that now exists.

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