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## Short-selling rule backfires

By Joanna Chung in New York

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An emergency rule protecting a select group of 19 financial companies from abusive short-selling has contributed to a decline in their share prices, a study has concluded, raising questions about the rule's effectiveness.

Short-sellers aim to profit from share declines, usually by borrowing a stock, selling it and buying it back after its price has decreased. In "naked" short-selling, the shares are sold without being borrowed first.

The emergency rule - due to expire last night - required investors to borrow the security first and deliver at settlement, but it only applied to shares in 19 financial companies.

It was issued by the US Securities and Exchange Commission last month amid alarm about the health of key financial institutions, including Fannie Mae and Freddie Mac, the government-sponsored mortgage groups, and Lehman Brothers, the investment bank.

However, the "impetus for the SEC's emergency order, that short-selling was adversely affecting the performance of the 19 financial stocks, is groundless", said Arturo Bris, professor of finance at IMD Business School in Switzerland, who conducted the study.

"Worse, the order has resulted in a decline in market quality for the emergency order covered securities compared with comparable financial stocks," he said.

"As a consequence, the restraints on short-selling contributed to a decline in share prices for the 19 stocks."

The 19 stocks lost 3.83 per cent in value - or about \$60bn - compared with their peers between July 21, when the rule went into effect, and August 4, he added.

Though the 19 shares have performed significantly worse than stocks of their peers this year, "after controlling for short sales, the performance of 19 stocks is still worse than for comparable firms", the study concluded.

Moreover, it said stocks other than the 19 had been shorted more heavily in 2007 and 2008.

The SEC said: "The emergency order's purpose was not to artificially prop up prices or restrict legitimate short sales, but to protect against illegal 'distort and short' schemes that could have threatened fair and orderly markets at the time of the order."

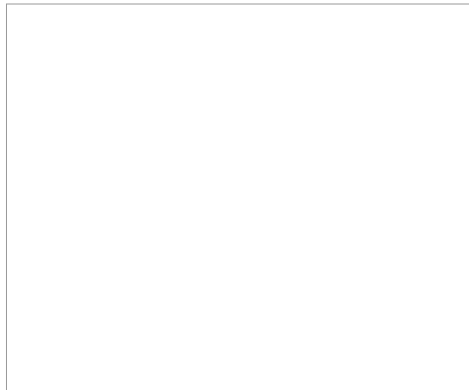
SEC officials, who are developing proposals for rule changes to guard against abusive short-selling in all shares, are still studying the impact of the emergency rule.

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