SEC short selling rule made little impact - studies

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578 words
14 August 2008
00:09
Reuters News
English

NEW YORK, Aug 13 (Reuters) - U.S. regulators' emergency rule to restrict "naked" short selling in 19 major financial stocks had little impact and may have even backfired, two studies of the rule's effects showed on Wednesday.

While overall short selling declined in nearly every firm affected by the rule, many of the 19 stocks still suffered declines in their share prices, the studies showed.

The U.S. Securities and Exchange Commission issued an emergency order last month requiring short sellers to pre-borrow stock in mortgage finance giants Freddie Mac and Fannie Mae and 17 other Wall Street firms, such as Goldman Sachs Group Inc and Citigroup Inc . While the rule expired at 11:59 p.m. on Tuesday, the SEC had billed it as an attempt to crack down on illegal "naked" short selling, that could allow reckless short selling of the stocks.

"While the SEC's intentions may have been good, their attempt to protect price with rule-making was quite flawed and without intended effect," said John Standerfer, Vice President of Financial Services for market data firm S3 Matching Technologies. "The market has its own mind."

An S3 study of market data showed short sells for the 19 stocks dropped by about 63 percent while the rule was in effect, but the firm concluded the rule was "ineffective," saying short selling "did not seem to be a significant factor" in the market's determination of price for the stocks.

Shares of Fannie Mae and Freddie Mac are off more than 20 percent since the protective rule was first announced, despite an almost 5 percent rise in the benchmark Standard & Poor's 500 index <.SPX> in the same period.

Even with the protection, S3 found the number of short sells in shares of Bank of America Corp were often higher while the rule was in effect than they were the day before the rule was announced. But despite the higher levels of short selling, Bank of America's stock price is up more than 40 percent in the past month.

A separate study from Arturo Bris, a finance professor at **IMD business school** in **Lausanne, Switzerland**, found that, even controlling for short selling, market efficiency had deteriorated more for the 19 stocks affected by the rule than for other comparable U.S. financial stocks.

Bris found that shares affected by the order lost about 3.8 percent of their value, compared to their peers -- a figure that translates to about a $60 billion loss for the firms' shareholders.

"Our belief is that naked short selling was never a problem with these stocks," said Eric Newman, portfolio manager at long/short fund TFS Capital in West Chester, Pennsylvania.

Indeed, prior to the SEC's rule only one of the 19 stocks, the U.S.-listed shares of Deutsche Bank , had been listed on the New York Stock Exchange's list that tracks stocks with "fails to delivers" -- an indication of naked short selling.

"We think the SEC are going to read into this data that a lot of short sellers exited positions," Newman added. "But we believe a careful look will show was that naked short selling was not ferreted out, but that it was regular legitimate short sellers who were closing their positions." (Additional Reporting by Kristina Cooke)

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