

SEC Disappointing Goldman Sachs Amid Vote on Short-Sale Curb

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By Jesse Westbrook

Feb. 24 (Bloomberg) -- The U.S. Securities and Exchange Commission is poised to curb some bearish stock bets, ending a yearlong debate between individual investors and Wall Street with a solution that fails to satisfy anyone.

A majority of the SEC's five commissioners will vote today to temporarily restrict short sales of a company's shares once it falls 10 percent, according to two people with direct knowledge of the rule. When the 10 percent threshold is triggered, traders could only execute short sales for the stock at a price above the market's best bid, said the people, who declined to be identified before the decision.

General Electric Co., Charles Schwab Corp. and more than 5,600 people who signed a petition sent to the SEC wanted a short-selling restriction that was always in effect, similar to the so-called uptick rule that the agency abolished in 2007. Goldman Sachs Group Inc. and hedge funds Citadel Investment Group LLC and D.E. Shaw & Co. lobbied against a limit.

"Nobody is going to be happy," said James Angel, a finance professor at Georgetown University in Washington who has served as an adviser to stock exchanges. "The benefit of this new rule is that it provides political cover to the SEC so they can say they did something."

The SEC said in March that it would consider restrictions on short selling, which involves the sale of borrowed stock in the hope of profiting by buying the securities later at a lower price and returning them to the shareholder. The decision followed a 19 percent drop in the Standard & Poor's 500 Index during the first two months of 2009 and lobbying from 27 members of Congress, including House Financial Services Committee Chairman Barney Frank, a Democrat from Massachusetts.

Uptick Rule

The lawmakers wanted the SEC to bring back the uptick rule, which barred investors from betting against a stock until it sold at a price higher than the preceding trade. The limitation had been in place for almost 70 years before the SEC scrapped it in June 2007. Four months later, the S&P 500 began a 17-month bear market that erased 57 percent of its value.

The plan the SEC will probably approve today is intended to be the least intrusive for markets and easier for securities firms to implement than the alternatives, the people said. The SEC ignored a request from trading venues including the Chicago Board Options Exchange to exempt market makers.

“We received thousands of public comments expressing every viewpoint imaginable,” SEC spokesman John Nester said. “In the end, the object is to gain insight from all the comments and then shape a rule that best protects investors.”

Boosting Confidence

SEC Chairman Mary Schapiro, a political independent, has defended the need for short-sale regulations on the basis that they will boost investor confidence. Democratic Commissioners Elisse Walter and Luis Aguilar also support curbs.

Republican SEC Commissioners Kathleen Casey and Troy Paredes aren't convinced benefits from limits on bearish bets will outweigh the costs and will likely vote against the agency's rules, the people said. Casey's office didn't return a phone call seeking comment and Paredes wouldn't respond.

Short selling was blamed by lawmakers, former Morgan Stanley Chief Executive Officer John Mack and investors for pushing the U.S. economy toward the brink of collapse by driving down bank stocks. Under pressure from politicians, the SEC temporarily banned bearish bets against almost 1,000 financial stocks in September 2008.

Finance, Turbines

Michael McAleve, a vice president at GE, urged the SEC during a May conference to restrict short selling all the time instead of just enacting circuit breakers following a 10 percent plunge. He said the Fairfield, Connecticut-based company, whose units range from a finance division to a producer of turbines for power plants, was concerned temporary curbs would encourage bearish bets because traders would rush in to execute short sales before the circuit breaker was triggered.

GE spokeswoman Anne Eisele said the company's stance hasn't changed.

There's no evidence the SEC proposals will reduce abusive short selling or boost investors' confidence, Paul Russo, the head of U.S. equities trading for Goldman Sachs, wrote in a September letter to the SEC. Bearish bets help expose fraud and prevent companies from becoming overvalued, he added. His New York-based employer is the most-profitable securities firm in Wall Street history.

Russo's letter reflects Goldman Sachs's current views, company spokesman Ed Canaday said.

Goldman Sachs, Chicago-based Citadel and D.E. Shaw in New York all urged the SEC against restricting short selling. If the SEC determined that new rules were necessary, the three companies encouraged the agency to opt for a circuit breaker. The SEC followed their advice.

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