

Kaufman, Isakson Say SEC Action a "Step Forward" But Fails to Solve Naked Short Selling Concerns

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Short Selling Concerns

Delaware, Georgia Senators dismayed SEC never sought comments on "hard locate" requirement

WASHINGTON, D.C. - Senators Ted Kaufman (D-DE) and Johnny Isakson (R-GA) released the following statement after the Securities and Exchange Commission voted 3-2 Wednesday to require short sellers - if a company's shares fall 10 percent in one day - to exceed the prevailing "bid" for the remainder of the trading day and the following day in short sales of that security.

"We are encouraged that three of the Commissioners finally took some action to protect investors from manipulative short selling. This circuit-breaker/bid test rule is a step forward. But in our view it will be of limited use, helping only in the worst-case scenarios that could occur during a terrorist attack or financial crisis. The uptick rule worked for 70 years as a systemic check on predatory bear raids; this approach will not provide investors with the same protections as an 'always-on' bid test.

"Moreover, the real problem is that the SEC does not have an enforceable rule to punish those who undertake market manipulation through abusive naked short selling and rumor-mongering. To this point, the SEC has not yet brought a single enforcement case in the 2008 naked short selling incidents that helped take down Bear Stearns and Lehman Brothers. Today's new rule does not address that glaring problem.

"We are also dismayed that the Commission has never sought comments on a 'hard locate' requirement for short sellers, even after eight senators pointedly made this suggestion last July and seven senators have co-sponsored a bill calling for this. The Commission still failed to seek comments even after the SEC acknowledged in a September roundtable that the naked short selling rule did indeed pose enforcement difficulties. What would have been the downside to proposing a firm requirement that before stocks can be sold short, the short-seller must have a legally enforceable right - and obligation - to deliver the stock at the time of settlement? Just by proposing that type of rule, the Commission would have been in a position today to adopt a pre-trade hard-locate requirement, or a circuit-breaker approach combined with a hard-locate requirement, instead of a bid test, for example.

"Unfortunately, in our view, the partial action taken by the Commission today will not provide investors with the same protections as the uptick rule, nor does it address the enforcement issues surrounding the current naked short selling rule."

BACKGROUND:

- On March 16, Sens. Kaufman, Isakson and Jon Tester (D-MT) introduced a bill (S.605) that calls for the following: "Not later than 60 days after the date of enactment of this Act, the Commission shall issue regulations prohibiting any person from selling securities short, unless that person demonstrates, at the time of the sale, that such person possesses, at the time of the sale, a demonstrable, legally enforceable right to deliver the securities at the required delivery date." Co-sponsors: Sens. Robert Bennett (R-UT), Saxby Chambliss (R-GA), Orrin Hatch (R-UT), Arlen Specter (D-PA).
- In a June 24 letter to SEC Chair Mary Schapiro, Sens. Kaufman, Isakson, Jon Tester (D-MT) and Rep. Carolyn Maloney (D-NY) wrote, "Focusing on the uptick rule alone, however, puts too narrow a frame on the problems associated with naked short selling. The problem at its root may be that the current rules against naked short selling are both inadequate and impossible to enforce."
- In a July 22 letter to Schapiro, Sens. Kaufman and Isakson and five other senators suggested a pilot program as proposed by the Depository Trust & Clearing Corporation (DTCC) to prohibit short sales that do not first acquire a "hard locate." Sens. Kaufman, Isakson, Carl Levin (D-MI), Jon Tester (D-MT), Sherrod Brown (D-OH), Orrin Hatch (R-UT) and Robert Menendez

(D-NJ) wrote: "This centralized 'hard locate' system seems to offer a viable way to eliminate 'over selling' of stock inventories, in that there would no longer be multiple locates on the same shares of a security. . The DTCC proposal could standardize requirements across the industry, can be configured in a way that will not disrupt markets, would streamline locate documentation requirements, and can be overseen directly by the SEC to ensure regulatory compliance." Sen. Arlen Specter (D-PA) later wrote to say he concurred in that letter.