

Short sellers find selves on SEC short list for blame

SEC to investigate rumors; measures outrage industry

By Joshua Boak | Chicago Tribune Reporter

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The Securities and Exchange Commission took emergency measures Friday that fingered one particular group for the violent tremors shaking the stock market.

Not the mortgage companies that buried Americans in debt. Not the investment banks that touted the debt as a solid investment. Certainly not the politicians whose policies helped birth the housing bubble.

The current villain is the "short seller," an investor who wagers that stock prices will fall. And with market turbulence hurting [Morgan Stanley](#), [Goldman Sachs](#) and others, short sellers are natural targets.

Both New York Atty. Gen. Andrew Cuomo and the SEC plan investigations of rumormongering and market manipulation by short sellers.

The SEC also banned the shorting of 799 financial stocks through Oct. 2, a move that infuriated many exchanges, traders and economists who warn it could throw a disastrous kink into the markets.

"This is the financial equivalent of war," said David Oser, chief economist at ShoreBank.

Even vultures have their virtues. Short sellers can keep the markets working smoothly, ensuring that prices are based on supply and demand. They have also exposed corrupt businesses such as Enron.

"Far from being the cause of the crisis, many short sellers were warning months and years ago about problems in this area," said Jim Chanos, a short seller who runs Kynikos Associates LP.

"Investors are best served when they can hear both the reasons to buy and the reasons to sell any given security," he said.

What investors such as Chanos do is sell borrowed shares, which they then buy back at a later date. Should the stock drop in value, the short sellers profit. Another way to short involves buying stock options.

"Short sellers are not evil," said [University of Chicago](#) economics professor Richard Thaler. "If you don't have short selling, then market prices are set by the most optimistic investors."

The SEC staff has recommended that traders responsible for providing liquid markets be excluded from the ban, although the commission has yet to officially modify its decision. A similar measure was adopted by the United Kingdom's financial regulator, which decided to allow the market maker exception.

Without an exemption, Chicago Board Options Exchange Chairman and CEO William Brodsky said, there could be "the sudden and severe removal of liquidity from the marketplace at the same time that the government is taking unprecedented steps to preserve it."

But some participants recognize there is wisdom in having a temporary ban on shorting financial stocks.

Many banks and insurance firms don't know how to value the debt on their balance sheets right now. The vacuum of reliable information can promote short selling that could harm otherwise stable businesses.

"[The SEC wants investors] to be able to make a slower, more carefully researched decision," said Stephen Wood, senior portfolio strategist at Russell Investments. "It's a global timeout, giving people the

ability to value these balance sheets in a less stressed, less immediate environment."

One possible way to moderate short selling could be the reintroduction of the uptick rule eliminated by the SEC last year.

After the United States sank into the Great Depression, Congress decided that investors could only short a stock if it increased in price during the most recent trade.

"It's not meant to prevent anyone from shorting the stock; it just makes it more difficult to short a stock," said David Brady of Brady Investment Counsel in west suburban Geneva.

"It causes you to think," he said. "And it reduces the temptation of the trader or hedge fund side to start rumors about the company and short the stock."