

September 16, 2008

Today the SEC Must Step Up

It has been just over one month since the SEC allowed its Emergency Order to lapse without putting in place an alternative means to address heightened market volatility and illegal short selling practices. This was a huge mistake. Under the Emergency Order, traders were not able to short a security without borrowing shares or entering into “bona fide” agreements to borrow them. In today’s markets, short sales continue to be at record levels, there are false rumors in the marketplace about the demise of financial firms, bear raids and abusive short selling are taking place, and there is significant disruption in the fair and orderly functioning of the securities markets. The markets are in a crisis.

Immediate bold measures by the SEC today are needed to constrain the abusive short selling and rumor mongering, to dampen volatility and to restore confidence in the markets. As the Federal Reserve Board and Treasury Department have done, the SEC must act now to ensure the stability and integrity of the markets. First, the SEC should heed market participants’ calls to immediately re-impose under its emergency powers the “Uptick Rule” (see our memos of July 1, 14 and 16). The Uptick Rule was effective for over 70 years in addressing abusive short selling and manipulative conduct. The decision to eliminate the Uptick Rule, after a pilot program, was prompted by the SEC’s view that market changes had rendered the Rule less effective. The limitations of the SEC’s pilot program, which was conducted in a period of a rising market and unusually low volatility, are painfully clear. The risks associated with unrestricted short selling in these periods of high volatility and large market declines were necessarily beyond the pilot’s scope.

Second, the SEC must today adopt a market-wide rule similar to the Emergency Order that recently lapsed. This was an effective measure to temper heightened market volatility and address abusive and manipulative short selling and should be reinstated.

In July, the SEC announced that it, FINRA and NYSE Regulation would immediately begin examinations of broker-dealer and investment adviser supervisory and compliance controls, with the goal of stemming the spread of false rumors intended to manipulate security prices. Shockingly, nothing further has been heard from the securities regulators. The SEC should promptly issue a public report of the results of those examinations and provide clarity on the extent to which abusive and manipulative short selling and spreading of false rumors is taking place (see our memos dated July 1, 14 and 16). Moreover, the SEC should promptly bring enforcement actions against those who are engaged in abusive and manipulative short selling.

All these measures are vital to any attempt to maintain investor confidence in the fairness and integrity of the markets. It is a time for action.

Edward D. Herlihy  
Theodore A. Levine

*If your address changes or if you do not wish to continue receiving these memos, please send an e-mail to [Publications@wlrk.com](mailto:Publications@wlrk.com) or call 212-403-1487.*