July 14, 2008

SEC Takes a First Step to Address Manipulative Rumor-Mongering; More Aggressive Action Still Needed

Yesterday, in an unusual Sunday statement, the Securities and Exchange Commission 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. While these actions represent a significant first step toward combating activities that threaten the integrity of the securities markets, more aggressive and immediate actions are needed in response to the current crisis.

The joint SEC/SRO examinations will focus on the supervisory and compliance controls of broker-dealers and investment advisers and whether the controls are reasonably designed to prevent manipulative conduct, including "the creation or spreading of false information intended to affect securities prices."

According to SEC Chairman Cox, "The examinations … are aimed at ensuring that investors continue to get reliable, accurate information about public companies in the marketplace." "They will also provide an opportunity to double-check that broker-dealers and investment advisers have appropriate training for the employees and sturdy controls in place to prevent intentionally false information from harming investors."

While this is an important first step, the SEC needs to undertake additional bold measures to constrain abusive short-selling and rumor-mongering. We urge the SEC to undertake a 45-day study of the markets, looking at all market participants, to determine the extent to which abusive and manipulative short-selling and spreading of false rumors is taking place, to issue a public report of its findings and to fashion appropriate regulatory and enforcement responses to what it finds. In addition, as we recently urged (see our memo of July 1, 2008), the SEC should immediately re-impose the Uptick Rule for a 120-day period in order to temper the heightened volatility and short-selling in the current market environment.

Of course, none of these prophylactic measures will have a significant impact in today's fragile markets if the SEC fails to promptly bring enforcement actions against those who are engaged in abusive and manipulative short-selling. Where appropriate, the Commission should coordinate its enforcement efforts with the Department of Justice and U.S. Attorneys.

Edward D. Herlihy
Theodore A. Levine
Caitlin S. Hall