SEC Revises 'Short' Rules Already

Agency's Turnabout After Three Days Provokes Criticism

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WASHINGTON—The Securities and Exchange Commission said shortly after midnight Monday that it would revise rules to curb short-selling that it had issued just three days before.

The SEC's latest change of direction on short-selling caught some market participants off guard and prompted criticism that the agency has miscalculated the impact of its rulemaking.

The SEC, in a release issued at 12:26 a.m. EST Monday, reversed a position it had taken Friday when it said that market makers couldn't short financial stocks after Friday. The new rules as of Monday: Those engaged in bona fide market making and hedging activity, including in derivative contracts, could continue to short.

"The purpose of this accommodation is to permit market makers to continue to provide liquidity to the markets," the SEC explained in the revised order. To try to prevent short sellers from using market makers to take big positions, the SEC said market makers couldn't short for a customer if it would give them a net short position in the security.

Also Friday, the SEC issued a temporary ban on short sales in nearly 800 financial stocks, including those who make markets in the securities. In a short sale, investors borrow shares and sell them, hoping the stock will fall and they can buy it back at a lower price.

The agency said Friday hedge-fund and money mangers needed to disclose short positions the first Monday following the trade.

Monday's rules: Hedge funds still must disclose their positions to the SEC, but the SEC will not make the trades public until two weeks later. The SEC also announced Monday that it had delegated to the stock exchanges the decision about which company makes the no-shorting list.

The SEC's Friday no short-selling list left off some companies with large financing arms, such as **General Electric** Co. and **Credit Suisse Group**, while other companies not embroiled in the financial crisis, including some health-care insurers, were included.

The Monday change prompted NYSE Euronext to send blast emails to its listed companies asking them to self-identify themselves as fitting criteria laid out by the SEC. Companies that were U.S. or foreign banks, brokers, money managers or parent companies of such financial institutions would qualify. Companies could also opt out from the temporary ban.

The NYSE added 71 companies by Monday evening, including GE, **General Motors** Corp., Credit Suisse, **GLG Partners**, **Canadian Imperial Bank of Commerce**, **American Express**, **Legg Mason**, and **Moody's** Corp. That list could grow. The Nasdaq OmX Group added 66 companies Monday.

The government response to the market upheaval has in many ways been unprecedented, and the SEC has been under pressure to do something from Wall Street chiefs, who were pleading for relief from short sellers they blame for driving stocks lower.

Erik Sirri, director of the SEC's trading and market division, said when the agency crafted the order Thursday night, they knew there would be amendments to the rule, but didn't want to craft them until after they spoke with market participants over the weekend.

Mr. Sirri said that while the SEC was aware of the implications the temporary short-sale ban would have, "the rule reflected a compromise balancing the limits of our authority, the need to avoid triggering a close-out event in OTC derivatives, and the demand for legitimate hedging by market makers."

But the agency's inconsistent response has opened it up to attacks—including by Republican presidential candidate Sen. John McCain, who said last week that SEC Chairman Christopher Cox should be fired.

"It looks like we have a bunch of amateurs that don't know what they're doing," said James Angel, an associate professor of finance at Georgetown University. "To come out and say let's ban short-selling shows the desperation of the regulators, and it shows the fact that they really haven't been thinking things through."

Monday's hastily revised rules prompted more critiques.

"Obviously, the amendments today are an attempt to remediate a failure to consider carefully what was going to happen," said Lawrence Harris, a former chief economist at the SEC from 2002 to 2004. "With the SEC basically granting its regulatory authority to the exchanges, they're basically asking the exchanges to write its own regulation. That's an extraordinarily irresponsible delegation of responsibility," he said.

The SEC "just decided from a risk point of view that we needed a time-out," said Charles Jones, a finance professor at Columbia Business School. "There are a lot of us out there who are wondering what the SEC is thinking, whether they've gone off the rails here."