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SEC Short Sale Rule Could Create a Bubble in Financial Stocks - Wall Street & Technology

Ivy SchmerkenNews

SEC Short Sale Rule Could Create a Bubble in Financial Stocks, Warns Brokerage Executive.
Hold's concern is that short selling in financial stocks will become more difficult and more expensive. Since the SEC's order is protecting the financial sector, and since firms don't want their stock prices to go down — and they "don't want to poke the SEC in the eye," —Hold says they're not going to lend shares as willingly. "Their incentive is to make short selling more difficult which will add to the bubble," he contends.

"In the short-term, it will create a bubble because of the suddenness of the action and because back-office systems don't have time to adjust," says Hold.

There are a couple of factors that could lead to a shortage in shares to borrow, according to Hold. One is that customers can't claim the right to borrow the same shares anymore. In the past, if a stock loan company gets calls from three hedge funds that want to borrow, the stock loan company is tempted to overpromise the same shares to its customers because chances are some of the firms won't use the shares, especially those with short-term strategies.

Some hedge funds only want to borrow the stock for a few hours. "Now, because the actual mechanics of the delivery process make this impossible, and because there's no fudge factor " the stocks have to be delivered " the same stock doesn't stretch as far and that reduces the supply," says Hold. In addition, the Wall Street firms need the shares for their own trading and market making. There are plenty of legitimate reasons to sell short and they're trading the stocks of the financial sector, say Hold.

Further, due to the changes that Wall Street firms have to make in their back-offices with software, Hold believes a lot of firms will sit on their hands or do nothing or mark the price (short-interest loan rates) higher. According to Hold, whose firm is self-clearing and can deal directly with the stock borrow sources, stock loan departments on the street have already marked their prices higher. "Where we used to be charged about one percent, now it's closer to five or six percent to borrow these financial stocks," he says. "We're going to have to pass along costs to traders and that's going to involve programming," says Hold.

Ivy is Editor-at-Large for Advanced Trading and Wall Street & Technology. Ivy is responsible for writing in-depth feature articles, daily blogs and news articles with a focus on automated trading in the capital markets. As an industry expert, Ivy has reported on a myriad ... View Full Bio

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