To: Mary Shapiro
Securities and Exchange Commission
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From: Joel Swadesh

I am writing to suggest that regulation of short selling be looked at from the framework of transparency and to propose specific solutions. Abusive short selling is successful because there is asymmetry of information. This asymmetry is particularly great between small investors and larger investors, since larger investors have greater access to corporate management. The function of most proposed regulatory solutions, such as circuit breakers and uptick limitations, is to slow down the price moves enough for information to be verified and diffuse to more investors.

It is an article of faith among short sellers that short selling is purely catalytic, inflicting no damage on companies beyond what would occur eventually anyway. This is false. For example, a false rumor can damage a company's access to credit. By the time the truth emerges genuine costs have been incurred. Even if the short-selling is based on true information, it may be inappropriate if it is based on inside information.

For small companies, concerns about short-selling are particularly at issue and, again, the reason is transparency. Large companies have access to free and paid media to tell their story. By contrast, a small company lacks this media access. A false rumor can inflict long-term damage on a small company.

There are other dangers of short selling that are not sufficiently appreciated. Naked shorting means that there is no upper limit to the gains and losses that can be incurred. And because short selling is often done on margin, the risks of a payment crisis are significant.

Short-selling is perfectly appropriate when it is based on research of publicly-accessible information. It helps to guard against investor complacency. It can serve a useful role in catalyzing stock price shifts. The critiques of short-selling do apply equally to rumor-mongering on the long side. But short-selling is under fire for just cause. I propose the following:

- Eliminate the use of margin in short-selling
- Make naked short-selling a criminal offense
- Set circuit breakers appropriate to the size of the company

The companies that deserve the strongest protections are the small ones. Companies like the major investment banks not only have means of countering false rumors, what happened with them is perfect illustrations of how short-selling can serve a useful function in puncturing the falsehoods that they put out in 2007 and 2008. To grant large companies very strong protections against short selling is to all but give them a license to lie to investors.