

SEC ISSUES EMERGENCY SHORT SELLING RULES ON BANKING STOCK

The US Securities and Exchange Commission (SEC) has announced the imposition of emergency rules aimed at preventing "naked" short selling in banking securities.

1. KEY POINTS

1.1 In force dates

The SEC's order will require that anyone effecting a short sale in certain listed securities must arrange beforehand to borrow the securities and deliver them at settlement. The order will take effect at 12:01 a.m. ET on Monday, 21st July 2008. The order will terminate at 11:59 p.m. ET on July 29, 2008.

The Commission may extend the order thereafter if necessary in the public interest and for the protection of investors, but for no more than 30 calendar days in total duration. In addition to this emergency order, the SEC will undertake a rulemaking to address these issues across the entire market.

1.2 Affected Securities

The move is particularly intended to protect investors in the securities of Fannie Mae, Freddie Mac, but will also cover primary dealers at commercial and investment banks, for example Lehman Brothers, whose share values have also been affected.

The securities affected are:

BNP Paribas Securities Corp
Bank of America Corporation
Barclays PLC
Citigroup Inc
Credit Suisse Group
Daiwa Securities Group Inc
Deutsche Bank Group AG
Allianz SE
Goldman, Sachs Group Inc
Royal Bank ADS (Royal Bank of Scotland)
HSBC Holdings PLC ADS
J. P. Morgan Chase & Co
Lehman Brothers Holdings Inc
Merrill Lynch & Co., Inc
Mizuho Financial Group, Inc
Morgan Stanley
UBS AG
Freddie Mac
Fannie Mae

1.3 Background Information on Fannie Mae and Freddie Mac

- Fannie Mae is more properly known as The Federal National Mortgage Association. It was created in 1938 to make sure that sufficient funds were available to mortgage lenders, then rechartered by Congress in 1968 as a publicly traded company
- Freddie Mac is the Federal Home Loan Mortgage Corporation, and was created by Congress in 1970. It buys mortgages from lending institutions and then either holds them in investment portfolios or resells them as mortgage-backed securities to investors.

- Between them, Fannie Mae and Freddie Mac own or guarantee about half of the US's \$12 trillion mortgage market. As a result, the corporations were affected particularly hard by the subprime mortgage crisis in late 2007 and early 2008.
- In 2005, Fannie Mae lost both its chief executive and chief financial officer, amid charges of accounting irregularities at the US mortgage giant. Fannie Mae was ordered to restate its earnings by the SEC, after the SEC ruled that its accounting was in breach of regulations.
- Congress charters the companies and gives them advantages to support their role in backing mortgage markets - such as letting them borrow more than \$2 billion each from the government in an emergency - but does not guarantee their debt.
- Freddie Mac is in negotiations with the SEC to enable it to gain approval to raise \$5.5 billion of new capital
- The sharp reductions in share prices for both companies caused the US Treasury to step in to provide both Fannie and Freddie with liquidity support and allow the Treasury to take an equity stake in the companies if needed. The move is likely to gain approval from Congress despite early opposition.
- The share prices have since staged a recovery, but the possibility of Government intervention which could dilute existing equity holdings has raised concerns over Freddie's ability to attract private investors to participate in a capital-raising.

2. FURTHER INFORMATION

The SEC's emergency rule can be found at the following link:

<http://www.sec.gov/rules/other/2008/34-58166.pdf>

Reference: RCUK/PTG/KG

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