UPDATE 1-Short sellers decry scapegoating as SEC eyes rules

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SHORTSELLING/REACTION

* SEC considering uptick, circuit breakers in Washington

* Short sellers defend strategy as necessary (Adds comments, background on short interest)

By Jonathan Spicer

NEW YORK, April 8 (Reuters) - Short sellers are the scapegoats and victims of politics, traders and asset managers said on Wednesday, as regulators met in Washington to propose new restrictions on the trading strategy that profits from falling stocks.

Members of the U.S. Securities and Exchange Commission recommended five new rules, including a modified "uptick rule," intended to relieve the downward pressure on plunging stock markets. ID:nN08529569

The SEC, which now will seek public comment, is under pressure from some lawmakers and executives to do something to stem the financial crisis -- but some short sellers said they are the unfair targets of questionable rules.

"It's perverse and silly. It's not economic," said Manuel Asensio, a veteran short-seller, whose Asensio & Co has identified dozens of cases of corporate fraud and profited by selling their shares short.

"There is no basis -- no moral basis, ethical basis, legal basis and, most importantly, no economic basis -- by which to claim society will be better served with this rule."

Short sellers sell borrowed shares with the hope of buying them back later at a lower price. They have been blamed by some as markets hit multiyear lows over the last several months.

"The market has functioned perfectly fine except for a very brief window of time under an unbelievably unusual set of circumstances," said Andrew Fishman, president of proprietary trading firm and fund of funds manager Schonfeld Group, which manages about $750 million.

"We shouldn't create rules that are going to burden the market 99 percent of the time for the one percent event."

Some 60 percent of brokers, hedge funds and other institutional investors surveyed by research and consulting firm TABB Group said liquidity will suffer if the original uptick rule is reinstated. More than 80 percent said hedge funds would be hit hardest.

The study, published last week, predicted a modified uptick rule was the most likely outcome. It noted bear markets such as the current crisis typically prompt the SEC to review rules and that "recent history shows that regulatory action against short selling has a sharp, short-lived impact."

Hedge fund manager Doug Kass, who heads Seabreeze Partners Management, said: "The problem is that the managements of the banks and brokers screwed themselves up, short sellers did not.

"Short sellers just made people notice how many bank managements lied like ministers of finance on the eve of devaluation."

The SEC may bring back the uptick rule, repealed in 2007 after decades of use, which allowed short sales only when the last price was higher than the previous price. It is also considering a modified version to account for trading and technology changes, which would focus instead on the last bid.

There are three options that include circuit breakers, which would trigger a temporary suspension of short selling a particular stock, or the temporary application of the price or bid test.

"(The SEC) has five different options, but there should be a sixth option: to keep the markets the way they are," said Richard Gates, portfolio manager at long/short mutual fund TFS Capital.

"It seems like short sellers are a total scapegoat in this instance and regulators want to look like they're protecting individuals."

Short interest on the New York Stock Exchange and Nasdaq Stock Market has fallen from highs in July until February, when it climbed back along with a rise in markets. (Editing by Andre Grenon) (Additional reporting by Jennifer Alban, Joseph A. Giannone, and Phil Wahba; Editing by Brian Moss)
