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Levin, Grassley Release GAO Report on Stock Clearing

WASHINGTON – Today, Senator Carl Levin, D-Mich., Chairman of the Senate Permanent Subcommittee on Investigations, and Senator Charles Grassley, R-Iowa, Ranking Member of the Senate Committee on Finance, released a Government Accountability Office (GAO) report providing an overview of how U.S. stock trades are cleared and settled, the role played by U.S. stock clearing companies, and the oversight provided by the Securities and Exchange Commission (SEC).

Senator Levin said: "A year ago I asked GAO to examine manipulative naked short selling, fails to deliver, and the effectiveness of the SEC's Regulation SHO. GAO's report on those topics is due soon. Today, GAO has provided an interim report on the infrastructure undergirding our stock markets – who records and clears U.S. stock trades, how trades are settled, and what the SEC does to oversee the process. Understanding this infrastructure will not only help ensure our markets work efficiently, but also enable us to strengthen market oversight, reduce fails to deliver that damage stockholders and stock prices, and stop stock manipulation and fraud, including abusive short selling."

Senator Grassley said: "This report sheds light on the important role that the SEC plays in making sure the underpinnings of the market remain structurally sound in order to maintain confidence in the integrity of the market and, in turn, the free marketplace itself. The report should help Congress and the public better understand the issues GAO will explore it its upcoming report on the effectiveness of the SEC's efforts to address naked short selling through Regulation SHO."

The GAO report describes the process used today to clear and settle stock trades by the National Securities Clearing Corporation (NSCC) and the Depository Trust Company (DTC), two subsidiaries of the Depository Trust and Clearing Corporation (DTCC). These entities clear and settle virtually all stock trades on U.S. stock exchanges. GAO also describes the SEC's oversight of the clearance and settlement system through its examination program.

The report includes a description of the process for identifying and addressing fails to deliver (FTDs), a term which applies to the situation in which a stock trader fails to deliver promised stock to a buyer on time. The report indicates that, although many FTDs are caused by processing delays or mechanical errors, they can also result from naked short selling. Naked short selling generally refers to a trader selling a security it does not own and has not borrowed.

The GAO report states that FTDs "can accumulate to a level that could affect the market for that security," "may deprive shareholders of the benefits of ownership, such as voting and lending," and "may be indicative of an illegal trading strategy known as manipulative naked short selling." GAO reports that, on December 31, 2007, the value of aggregated FTDs in U.S. stock markets was $7.5 billion.

In 2004, the SEC issued Regulation SHO to address large and persistent FTDs and manipulative naked short selling. In 2008, the SEC took additional actions to restrict naked short selling. On April 8, 2009, the SEC will hold a Commission meeting to consider proposals to address to short selling. GAO's report on manipulative naked short selling, FTDs, and Regulation SHO is expected in late April or early May.

The GAO report can be found online at http://levin.senate.gov/newsroom/supporting/2009/GAO.StockClearing.032609.pdf.

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