Today's Guest
SCOTT ROTHBORT
The Edge

Scott Rothbort, founder and partner of LakeView Asset Management, LLC, is filling in for Doug Kass today. Email Rothbort at scott.rothbort@thestreet.com. Doug Kass will return on Thursday.

What Must Be Done to Ensure Fair and Orderly Markets

2/28/2007 8:10 AM EST

QuickTake

Bullish SPY

- Investor confidence and credibility of the financial markets' infrastructure were deeply tarnished yesterday.
- Years of regulatory and technological advances following the 1987 crash were destroyed in a matter of minutes.

Investor confidence and the credibility of the regulatory and technological infrastructure of the financial markets were deeply tarnished yesterday. Years of regulatory and technological advances following the 1987 crash were destroyed in a matter of a few minutes. Here is what must be done immediately to ensure that fair and orderly markets ensue in the future:

1. The **SEC** experimental removal of short sales on common stock without an up-tick must be abandoned. I brought this to this site's attention last May when the practice of short selling without an up-tick was harmful to the markets. The up-tick rule was designed to prevent bear raids. Yesterday was one of the most egregious examples of such practices I can recall.

2.The **SEC** exemption of ETFs from short sale without an up-tick must also be removed with the exception of broad-based index ETFs that have similar futures contracts associated with that index such as the **S&P 500** (SPX/SPY).

3. The practice of slam dunking and trading of married puts to stocks embedded in sector ETFs must also be prohibited and strictly enforced. This was also something that I brought to light on this site nearly three years ago. Jim Cramer picked up on these activities and we discussed it on the old "Kudlow & Cramer" show, making it a public issue. The SEC and SROs failed to pick up on the problem then and it has now festered for the last three years having finally hit a crescendo yesterday. No time is better than now to correct these problems.

4. Market data services and publications, which publicly disseminate index data that are broad based or underlie exchange traded ETFs or derivative contracts must be regulated under the Securities Act of 1933, the Securities Exchange Act of 1934 and/or one of the Commodities Acts. I will let the securities experts figure out which one applies. Regulations must then be established to enjoin these index providers to ensure the timely, orderly and accurate aggregation, calculation and publication of such information.

5. Electronic markets and hybrid markets are excellent forms of securities trading, given the technological advances of the Internet and desktop computing that we have enjoyed over the last decade. However, there is a flaw in the design of these markets. That flaw was the elimination of the perceived flawed component of the process -- the human element. Under the auction/specialist system, stocks could be halted in fast markets by the exchange or the specialist for order imbalances until price discovery could re-establish an orderly market. We are now in an electronic world whereby the last vestiges of the specialist system function as ATM machines rather than market participants. I suggest that all stocks must be assigned to a specialist -- whether listed or OTC -- who act as the primary market participant (PMP) for a stock and can halt trading for imbalances. The PMP would be designated by the listing company and approved by the SRO or SEC. Putting the human element back into the markets will be a positive, not a negative.

6. Enforce the circuit breaker program trading regulations that were enacted after the 1987 crash. Go a bit further and update those prohibitions for the more modern technologies and derivative strategies now in use. Fine or revoke licenses for blatant abuse of the circuit break rules.

7. Improve stock market surveillance techniques to update techniques and/or begin to monitor up-tick, circuit breaker, derivative and other violations.

8. In a similar manner that short interest is published by exchanges, require public companies to publish the amount of authorized stock buy backs and amounts remaining under these plans.

9. The **Federal Reserve** must modify Regulation T to reflect risk-based extension of credit. Even better would be an international standard for securities margin and stock lending much as the Basel Accords for international bank lending.

10. Remove time delays for stock quotations. Right now real-time quotes are available only through executing broker sites or through subscription. Any fees lost by the exchanges for current real time subscriptions can be made up by increasing exchange fees. In the end we will all pay but at least all market participants -- active, infrequent or passive -- will have equal access to market data.

Position: *Long stock - SPY*