Citizens for Development

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To: Chairman, Senate Committee On Finance
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Subject: **Current law permits short-selling of a security by brokerages and mutual fund principals (Chairman and BOD) based on borrowing the security from their clients and mutual funds. This law induces a breech of trust between a mutual fund company and mutual fund holders and between a brokerage and its clients. It induces naked robbery of a vast majority of American mutual fund investors by a few mutual fund company principals and brokerages. This law must be repealed in the best interest of American mutual fund investors to avoid potential social instability that may erupt due to such robbery.**

Dear Honorable Chairmen:

Our current law permits a mutual fund company's principal to short-sell securities by borrowing from its mutual funds held by retirement funds and passive investors. Fund managers' pays and bonuses are directly controlled by their fund company's principal (Chairman and CEO). If mutual fund company principals are allowed to short-sell securities by borrowing from mutual fund accounts, then they can easily transfer wealth from retirement accounts and passive investors through pecuniary inducement of their subordinate fund managers. This law thus permits naked robbery and severe breech of trust between fund investors and mutual fund company principals. This law must, therefore, be repealed in the best interest of vast majority of American taxpayers, lest social and financial instability may ensue as in Great Depression.

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We must have a new regulation: no mutual fund company's principal is permitted to short-sell a security by borrowing the same, directly or indirectly through a hedge fund, from mutual funds maintained by the company.

The current law similarly permits a brokerage house to short-sell a security by borrowing the same from its own clients. While the clients are not under the control of a brokerage house, they are often induced to buy a security as brokerages give false support through huge blocks at bid prices. Brokerages often succeed in creating an **irrational exuberance** through fake supports at bids. After clients buy enough of a security (even though margin borrowing), brokerages remove their supports and then resort to creating **irrational panic** by offering large blocks of shares at decreasing ask prices to induce rapid fall in prices to induce clients to sell off at losses. Artificially induced irrational exuberance and panic succeed because investors do not buy or sell a security for any reason other than increasing their wealth. Individuals and fund managers keep selling [buying] securities whose prices keep dropping [rising] unto a threshold. Irrational exuberance-panic cycles trigger volatility that took NASDAQ to 5000 and then drop to 1100 in about a year. Brokerage houses thus transfer wealth from their own clients and mutual funds. This is strategic robbing permitted by current law by which a brokerage can short-sell a security by borrowing the same from its own clients.

We must have a new regulation: no brokerage is permitted to short-sell a security by borrowing the same, directly or indirectly through a hedge fund, from its own clients.

Should SEC extend its support, I shall conduct research to find out if wealth transfer has taken place from clients to their brokerages and from mutual funds to their principals. That it is possible under the current law is very obvious. That mutual funds are shrinking and hedge funds are growing should lend indirect proof that wealth transfer is taking place. Some day the whole society will wake up and panic like in Great Depression, unless you amend the law on short-selling.

With best regards,

Sankarshan Acharya

* ***Citizens for Development*** is a public service entity seeking no public funding to (i) promote human development without jeopardizing environment, (ii) formulate rational policies for governance and economic development of humans while maintaining the integrity of environment, (iii) operate within the ambit of existing laws and the constitution, (iii) pursue vigorously for repealing irrational laws procedures, policies and systems, (iv) target no one personally while rejuvenating the collective pride of all citizens, (v) search for optimal, not necessarily the ideal, solutions to human problems, and (vi) strive for deployment of latest human wisdom to devise rational rules, laws, procedures and systems for governance and progress of society.

Sankarshan Acharya is a graduate of IIT and holds Ph.D. in Business Finance from Northwestern University. He has served as a bank regulator working on American competitiveness at the Board of Governors of the Federal Reserve System (USA). His works have been adopted in the U.S. banking law. He was an adviser to the Board of Directors of the Federal Deposit Insurance Corporation (USA) and served as Chief Industrial Engineer in private industry in India. He has taught corporate finance, options and futures markets and fixed income securities markets in New York University, University of Illinois, and Hong Kong University of Science and Technology, and managerial economics at the National Institute for Industrial Engineering (Mumbai).