The Security Traders Association of New York, Inc.
Member of the Security Traders Association
39 Broadway, Suite 1840 New York, NY 10006 ● P: 212.344.0410 ● F: 212.943.8478

Kimberly Unger, Esq.
Executive Director

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Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F. Street, N.E.
Washington, DC 20549-1090

RE: File No. S7-08-09
Proposed Amendments to Regulation SHO

Dear Ms. Murphy:

The Security Traders Association of New York, Inc. ("STANY") respectfully submits this letter in response to the Securities and Exchange Commission's (the "SEC" or the "Commission") request for comments on proposed amendments to Regulation SHO under the Securities Exchange Act of 1934 (the "Exchange Act").

The Security Traders Association of New York is the voice of the trader in the New York metropolitan area. STANY represents approximately 1,200 individuals, all engaged in the buying, selling and trading of securities. As such, we are uniquely qualified to discuss rules and regulations affecting the purchase and sale of securities. STANY is the largest affiliate of the Security Traders Association (STA). STA is a multinational professional trade organization that works to improve the ethics, business standards and working environments of its members. Neither STA, nor STANY, represent a single business or business model, but rather provide a forum for traders representing institutions, broker-dealers, ECNs, ATSs and floor brokers to share their unique perspectives on issues facing the securities markets. Our members work together to promote their shared interest in efficient, liquid markets, as well as in investor protection. We believe that strong and efficient markets require an appropriate balance between effective regulation and innovation and competition.

STANY thanks the Commission for the opportunity to present the views of its members regarding the proposals to amend Reg. SHO and reinstate some form of price test and/or introduce a circuit breaker for short sales. Although the opinions of market participants differ as to the merits of the five alternative tests advanced by the Commission, the majority of our members agree on key aspects of the proposals and have common concerns about amendments to Reg. SHO. STANY believes that any regulation which restricts liquidity and hampers price discovery does a disservice to the markets. This disservice must be weighed against the realistic potential benefits of the regulation. As market professionals with specific knowledge of the functioning of the equity markets, we believe that price restrictions on short sales will negatively impact liquidity, will be difficult and costly to implement and enforce, and will ultimately provide no real value to the markets.

The Committee on Capital Markets Regulation[1] (the "Committee") released a report on May 26, 2009 entitled *The Global Financial Crisis, A Plan for Regulatory Reform Recommendations to Reduce Systemic Risk and Make Markets More Transparent*, in which it outlined a plan for regulatory reform in direct response to the most serious financial crisis of the past 80 years. While the scope of that report is far broader than the issue at hand, we refer to that report in so far as it lays out principles of good regulation. The Committee acknowledged that the cost benefit rule must be applied to all other principles of good regulation and held as a cornerstone for its work the premise that; "… a given regulation should be promulgated only when its benefits outweigh its costs. Furthermore, if different kinds of regulation can achieve the same benefit, the regulation with the least cost should be adopted."[2] We agree and believe that any analysis of short sale regulation must include an analysis of the costs and realistic benefits of such regulation.

We understand that the Commission has received hundreds, if not thousands, of comments in response to this rule filing and that the pure weight of those comments is in favor of "reinstatement of an uptick rule." While we have not read all of the submitted letters, we have read enough to know that a belief exists among many of the concerned investors and issuers that reinstatement of an uptick rule will prevent bear raids and market manipulation, will strengthen the market and, according to some, will bring the market back to pre-summer 2008 levels. These letters reflect anger at short sellers and a belief that they are responsible for damaging the US equity markets. Some have expressed anger at the SEC for its removal of the rule in 2007, as well as hope that reinstatement of the rule will effect positive change in the value of stocks. While we appreciate the frustration that is evident in these letters, the expressed comments place undue blame on short selling and unrealistic expectations on the effects of reinstatement of an uptick rule. Likewise many of the comments display confusion between naked short selling and legitimate short selling in compliance with SEC rules.

In any event, an uptick rule cannot simply be "reinstated." The uptick rule never applied to stocks listed on NASDAQ. At most, reinstatement can only apply to stocks listed on the New York Stock Exchange ("NYSE") when trading in NYSE stocks occurred in a non-automated environment. Reinstatement of the rule therefore would also require unwinding Regulation NMS ("Reg. NMS") and restoring the NYSE to its former non-automated environment. We can think of no justification for undoing this important market structure reform.

Moreover, because of the nature of Reg. NMS, a reinstituted uptick or modified uptick rule would, unlike the original rules, shift the burden of compliance and handling of the restrictions from the execution point, the exchanges, to the order entry point, the broker dealers. This is a significant difference that would place enormous financial and compliance burdens on broker dealers. These burdens are not reasonable unless there is real and measurable proof that the regulation will be effective and will justify the costs. We have not seen, nor are we aware of, any evidence that the potential benefits would merit this costly and burdensome regulation.

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[1] The Committee on Capital Markets Regulation is an independent and nonpartisan 501(c) (3) research organization dedicated to improving the regulation of U.S. capital markets. Twenty-five leaders from the investor community, business, finance, law, accounting and academia comprise the Committee's membership. The Committee co-Chairs are Glenn Hubbard Dean of Columbia Business School, and John L. Thornton, Chairman of the Brookings Institution. The Committee's Director is Professor Hal S. Scott, Nomura Professor and Director of the Program on International Financial Systems at Harvard Law School. The Committee's research regarding the regulation of U.S. capital markets provides policymakers with a nonpartisan, empirical foundation for public policy.

[2] Committee on Capital Markets Regulation, "The Global Financial Crisis, A Plan for Regulatory Reform Recommendations to Reduce Systemic Risk and Make Markets More Transparent," Executive Summary p.4.

Advocates for reinstatement of the uptick rule call for its return on the grounds that it will reduce unfair downward volatility. Absent from these cries for reinstatement is the recognition that short selling reduces unfair upside volatility. Volatile speculation that a stock price will increase is just as likely to harm investors who buy in response to the frenzy only to discover too late that the underlying fundamentals of the company do not support the increased price. The common element in these letters and comments is the lack of empirical evidence to support the claims made therein.

The Commission's elimination of the uptick rule in 2007 is an easy target for the anger of investors and issuers looking to cast blame for the downturn in the markets. It is likewise an easy target for market pundits and the press looking to fill air time. As participants in the markets, we empathize with the Commission. The political outcry against short sellers makes regulation in this area a highly charged issue that is in danger of being unduly influenced by arguments that are not supported by credible data. Despite the pressure to do something, sympathy and political pressure must not override intelligent rulemaking. While we commend the efforts by the SEC, Congress and the administration to review current regulation and implement reforms, we cannot agree with those who believe that reinstating a price test for short sales is a viable or effective solution to any real issue facing our markets.

<u>Additional regulation, imposing limitations on short sales, is neither necessary, nor in the best interests of the markets. Existing regulation, if properly enforced, can efficiently and cost effectively address concerns associated with short sales without threatening liquidity.</u>

The evidence has shown that despite propinquity there is no causal relationship between elimination of the uptick rule and the decline in the US markets in 2008. The Office of Economic Analysis's ("OEA") report of its study of short selling during the fall of 2008 shows that short sales are not solely, if at all, the cause of declining stock prices. The OEA concluded that "Our results are inconsistent with the notion that, on a regular basis, episodes of extreme negative returns are the result of short selling activity. On average, short sale volume as a fraction of total volume is higher for periods of positive returns than for periods of negative returns."

The Commission should not be quick to discount the results of this, and other studies, which fail to establish that short sellers are responsible for the decline in stock prices during volatile market conditions. The only thing linking the elimination of the uptick rule to the market downturn is coincidence.

THE ANTICIPATED BENEFITS TO BE GAINED BY ANY OF THE PROPOSED TESTS DO NOT OUTWEIGH THE ASSOCIATED COSTS AND RISKS.

The SEC has acknowledged, and we concur, that there are many benefits to short selling and that selling short is a legitimate investment strategy that adds to liquidity, lowers spreads and acts as a tool in price discovery. As there is nothing inherently wrong with the practice, why regulate it in such a way as to potentially or effectively eliminate such a useful market device? To what purpose?

In evaluating the proposed amendments to Reg. SHO, we ask: What is the goal of the Commission in proposing a reinstatement of limitations on short selling? What are the benefits that are sought and what is the likelihood that those benefits will be achieved? Do the costs and potential costs in terms of unintended consequences (implementation costs as well as the impact on liquidity and pricing efficiency in the market) outweigh those achievable benefits?

While considering what gains are hoped to be achieved by a price test on short sales, it is important to keep in mind that the costs of implementation of an uptick or modified uptick rule (with or without a circuit breaker) would be significant. In addition to the loss of liquidity, anticipated costs would include modifications to market data feeds, trading system interfaces, execution management systems, order management systems, order audit trail reporting (OATS), and FINRA's trade reporting requirements. Broker dealers and vendors may also be required to increase their system capacities and implement functionalities to mark orders short exempt and take and retain snap shots of market data.

If the Commission is concerned that without an uptick rule stocks are vulnerable to bear raids, then the regulatory focus should be on naked short selling and manipulation. While harmful to liquidity, a bid or tick test will not stop naked short selling and bear raids. A person who wishes to take a short position will still be able to sell into an uptick and, with an uptick being only a penny, there is little or no deterrent to selling short. There are also other synthetic trades that can be done to have the same effect as selling short.

If the goal of the proposed regulation is to improve investor confidence in the markets, we believe that there are more effective and less costly ways in which to foster confidence. We do not believe that the day to day perception of the markets will be altered by imposition of any of the alternative tests proposed in the filing. At most, the rules may placate those seeking change for a time. Because price restrictions will not prevent manipulative behavior and will not have a material positive impact on market activity, any gain in confidence will be short lived. On the contrary, price limitations on short selling are likely to obfuscate price signals and lead to wider spreads and greater volatility, which could further frustrate investors and issuers.

We are concerned that ineffective, unenforceable regulation is likely to have the opposite effect on perceptions. Ineffective, or worse, harmful regulation, with unintended negative consequence is likely to do more harm than good to investor confidence. Passing regulation which at best will have a neutral effect and at worst could damage the markets, is not the proper response to investors and/or issuers who are unhappy about falling stock prices, nor is it the appropriate response to political pressure.

The Commission is in an untenable position. Given that an uptick rule cannot work where there are multiple points of execution, it is doubtful whether the SEC can respond to political pressure, if that is the goal of the Commissioners and staff. Those who are most vocal in their requests for changes to the rules governing short selling want the Commission to "restore the uptick rule." Anything less than that is likely to be perceived as giving in to the industry. If some other form of price test is imposed and is ineffective (as we suspect it will be) and harmful (as it might well be), the Commission will likely be faced with criticism for not "reinstating the uptick rule" as demanded by members of Congress and many who have commented on this rule filing.

While we understand that some regulation in the area of short selling is necessary, we agree with the principles set forth by the International Organization of Securities Commissioners ("IOSCO")[3] Technical Committee on Short Selling ("Technical Committee.") The Technical Committee published a consulting report entitled *Regulation of Short Selling*, which contains proposed principles designed to help develop a more consistent international approach to the regulation of short selling. The report released in March 2009 supported short selling as a mechanism for price discovery that should not be hindered. [4] The goal of the committee was to "strike a balance between realizing as much as possible the potential benefits of short selling (such as correcting overpriced stocks, facilitating price discovery, facilitating hedging and other risk management, and promoting liquidity through market making) whilst reducing the potential risks associated with short selling"[5] Rather than placing limitations on short selling activity, the Technical

[3] The IOSCO is recognized as the leading international policy forum for securities regulators. Its members regulate more than 95% of the world's securities markets in more than 100 jurisdictions.
[4] International Organization of Securities Commissioners Technical Committee on Short Selling "Regulation on Short Selling Consultation Report of the Technical Committee of International Organization of Security Commissioners" March 2009; available from http://www.iosco.org/news/pdf/IOSCONEWS140.pdf ; Internet.
[5] Ibid, p. 7

Committee's suggestions include strict settlement of fails to deliver, some form of reporting of short sales to the market or market authorities, effective compliance and enforcement systems designed to monitor settlement failures, and the inclusion of appropriate exemptions for certain types of transactions necessary to the functioning and development of an efficient market.

The Commission's decision to eliminate the uptick rule was well reasoned and should not be reversed by adoption of any of the proposed amendments.

Even if it were possible to turn back the clock and reinstate an enforceable uptick rule in a post Reg. NMS environment, there is no evidence to suggest that such a rule will have a material and positive impact on the markets. The Commission's determination that price restrictions were ineffective in damping volatility in a fast moving market and that regulation focused on preventing abusive conduct like naked short selling and market manipulation was more effective, is as valid today as it was in 2007. We wholeheartedly concur with the Commission's conclusion that, "…short sale price restrictions have become not only unnecessary, but also their continued maintenance will serve only to interfere with the mechanism of an efficient market."

Absent empirical evidence demonstrating that the Commission, OEA and others were wrong in 2007, we see no reason to reinstate a rule which was not designed to work in a market with dual listings and multiple execution venues. The Commission eliminated the rule after the SEC and academic studies showed that it did not work in markets dominated by electronic trading. To reinstate the rule "because it was effective for 70 years" ignores the fact that since its elimination in 2007 there have been significant changes in trading in the US equity markets occasioned by the institution of Reg. NMS. The only apparent reason to reinstate a price test for short sales is the belief that to do so would restore investor confidence in the markets. We question whether reinstatement of an ineffective rule will have any meaningful positive impact on investor psychology.

Analysis of additional regulation of short selling requires a distinction between naked short selling and market manipulation on the one hand and selling short as a legitimate market strategy and tool needed by market makers on the other.

NAKED SHORT SELLING AND OTHER FORMS OF MARKET MANIPULATION ARE VIOLATIONS OF EXISTING SEC RULES

STANY opposes violations of the securities rules and market manipulation. Naked short selling is proscribed by current SEC rules. Equally vexing, and tied to the discussions of short selling, is the intentional manipulation of stock prices through the spread of false rumors. Vigorous prosecution of those who start and/or spread false rumors with the intension of driving down (or up) the price of a stock and profiting from the decline (or increase), should act as a deterrent to those who would engage in such manipulative behavior.

The SEC has a host of regulations which, when properly enforced, effectively regulate abusive and manipulative short selling. Rules 10b-5, 10b-21, 203 and 204T of the Exchange Act provide the Commission with more than adequate ammunition to police and prevent manipulative short selling. The SEC's regulatory improvements in 2008 have provided added muscle to the regulations regarding short selling - penalties if a short seller does not deliver within T+ 3, disclosure requirements for certain short sellers, and naked short selling anti-fraud provisions. Rather than attempting to reinstate ineffective regulation, the SEC should strictly enforce these rules.

Unlike price tests, Rule 204T seems to have been remarkably effective in curtailing naked shorting. Rule 204T requires clearing firms to close out short sales that do not settle by T+3 and imposes strict penalties on firms whose internal desks or customers violate the rule. Until a failed trade settles, those firms must pre-borrow shares for any new short sales in the security subject to the fail. While fails can occur for several reasons, it is generally thought that abusive naked short selling is the primary reason for fails to deliver. According to the OEA, the average daily number of stocks on the threshold list decreased from 600 in July 2008 to 63 in March 2009 and overall fails to deliver declined 81% during that same period.

It appears that Rule 204T has been effective and we suggest that the rule, which is scheduled to expire on July 31, 2009, be enacted as a permanent rule and that enforcement be made a priority. Rule 204T, together with other existing rules, if strictly enforced are more than adequate to police, prevent and punish participants in the market who affect naked short sales with the intention of putting downward pressure on stock prices for financial gain.

Reinstatement of a price test for short sales, however, will not deter rogue participants in the markets, bent on manipulation through rumor or naked shorting. In a letter submitted by Overstock.com (one of the most vocal issuers on the topic of abusive short sales) to the Commission dated May 29, 2009, Overstock's Chairman and Chief Executive Officer, Patrick M. Byrne, Ph.D. accurately summed up the limitations of an uptick rule when he wrote, "An uptick rule may slow manipulative bear raids (not by much, since a manipulative trader can easily create an uptick), but it will not stop or detect them- nor will it stop manipulative naked short selling."[6]

To the extent that manipulation through false rumors is a legitimate problem, the SEC has the power, under current anti-fraud and anti-manipulation regulation, to bring actions for fraud and market manipulation and should do so vigorously. NYSE Rule 435 (5) also addresses rumor mongering. In November 2008, FINRA proposed its own rule relating to the spread of rumors likely to impact stock prices. Although FINRA's originally proposed rule was deemed overly broad and was soundly rejected, FINRA has recently proposed an anti-rumor mongering rule similar to NYSE Rule 435 (5). Taken together, these rules should be adequate to deter the manipulative use of false rumors. We believe that strenuous enforcement of these rules would go a long way toward achieving the goal of enhanced confidence in our markets. Actions against market manipulators will send a message to those who would transgress the law, as well as to "Main Street," that the "cops on the beat" are hard at work. It is this type of action that will create a lasting and meaningful restoration of confidence in the US markets.

Given that the current regulation is already adequate to police and prevent abusive practices such as naked short selling, we are not convinced that there is any need for further restrictions on legitimate short selling activity. Many participants in the industry have responded to the Commission's request for comment by selecting one of the five proposed alternatives or some variation thereon, on the grounds that they believe that the SEC, under tremendous political pressure to reinstate the uptick rule as a way to "restore investor confidence" and "make people feel better", will disregard the available empirical evidence, and impose some sort of regulation as "the easiest way to quickly re-instill confidence" in the markets. Despite this reluctant "assent" to some form of regulation, our members believe that price restrictions are too costly to implement, monitor and enforce, will be largely ineffective and have little, if any, positive impact on trading, while having a significant negative impact on liquidity, pricing and spreads.

LEGITIMATE SHORT SALES ARE BENEFICIAL TO THE MARKETS

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[6] Patrick M. Byrne, Ph.D., Chairman and Chief Executive Officer, Overstock.com, Inc., May 29, 2009, p. 1., available at http://www.sec.gov/comments/s7-08-09/s70809-2850.pdf, Internet.

STANY concurs with the Commission's long held view "that short selling provides the market with important benefits, including market liquidity and pricing efficiency."[7] We believe that the Commission was wise to study the impact of the uptick rule. Significant developments in the market over the past 70 years, including decimalization, and innovation which gave rise to ECNs, matching networks, multiple exchanges and automation, merited a review of the efficacy of the uptick rule. Through evaluation over an extensive pilot program, the Commission concluded (and we believe rightly) that there is "little empirical justification…for maintaining short sale price test restrictions."

Legitimate short sales serve as a key mechanism for generating market liquidity, securing price discovery, and fostering corporate accountability and responsibility. Legal short selling is a critical component of overall liquidity without which our markets would be degraded. Given the benefits of short selling, its restriction through a price test (or the elimination of the exemption currently available for bona fide market makers) will have an immediate and negative impact on liquidity and on the efficiency of the markets.

Liquidity- the ability of those who want to buy to find stocks to purchase and the ability of those who want to sell to find a buyer for their stocks- is a key component of any efficiently operating market system. Without adequate liquidity on both sides of the market, the natural effects of supply and demand will drive stock prices either lower or higher depending upon whether the lack of liquidity is on the buy or sell side. Market makers and specialists are charged with the responsibility of maintaining orderly markets and are consequently required to maintain two sided markets, in other words stand ready to buy and sell when necessary. As the Commission notes, "Market liquidity is often provided through short selling by market professionals, such as market makers (including specialists) and block positioners, who offset temporary imbalances in the buying and selling interest for securities. Short sales effected in the market add to the selling interest of stock available to purchasers and reduce the risk that the price paid by investors is artificially high because of temporary imbalance between buying and selling interests."[8]

Short selling is an especially important tool in the options markets. When an options market maker facilitates a customer trade it may be necessary for the options market maker to hedge his or her risk by selling short the underlying stock. These trades are neither manipulative nor intended to destabilize the price of the security. Rather they are related directly to a transaction in the corresponding option and are risk reducing hedges which provide liquidity to investors. An exemption for option market makers has permitted them to provide liquidity and depth to the market for listed options. Without the ability to hedge risk, liquidity in the options market will be significantly impaired and the costs associated with using options to protect against risk will be higher for those customers seeking to hedge positions. The negative impact that short sale restrictions would have in the options market should not be underestimated. The temporary ban on short sales on certain financial services stocks between September 19, 2008 and October 9, 2008 demonstrated the impact of short sale restriction on liquidity. Spreads and volatility in both equity securities and in options increased as liquidity decreased.[9]

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[7] Securities and Exchange Commission, 17 Fed. Reg. 18044 (Apr. 20, 2009)

[8] Securities and Exchange Commission, 74 Fed. Reg. 18044 (Apr. 20, 2009)(17 C.F.R. 242)

[9]Goldman Sachs, *Equity Execution Strategies – Street Smart*, "The Short-Sell Ban and Quoted Spreads" (October 13, 2008), available at https://gset.gs.com/cgi-bin/upload.dll/file.pdf?z0112210az8ee8ee47f49b4838a86c6d0e7c1db688, Internet. Goldman Sachs research covering the period from September 2nd through October 10th shows that on the first day of the ban, September 19th, spreads on ban stocked increased 27 percent relative to non-ban stocks and remained higher throughout the ban. On October 1st the spreads on ban stocks widened further, averaging 50 percent higher relative to non-ban stocks. Immediately upon the ban ending on October 9th, spreads on ban stocks narrowed sharply from 50 percent higher to only 17 percent higher than non-ban stocks. In addition, volume in ban relative to non-ban stocks was lower during the ban consistent with the possibility that useful liquidity dissipated. See,

Likewise, we should not take for granted that the markets in the United States are among the most liquid in the world and that our equity markets functioned extremely well during recent times of turmoil. Although stock prices may have declined, the markets themselves functioned smoothly providing those who wished to buy and sell efficient venues for their transactions. It is imperative that the Commission be mindful of the impact that can be caused by regulation and insure that any enacted regulation preserve the liquidity, efficiency, transparency and price discovery that are present in the markets today.

<u>The proposals submitted by the Commission have serious flaws which make them costly to implement, difficult to enforce and of little practical value given the nature of the markets since Regulation NMS was fully implemented in October 2007.</u>

REINSTATEMENT OF THE UPTICK RULE IS UNREALISTIC IN
A POST REG. NMS ENVIRONMENT.

In October 2007, the SEC fully implemented Reg. NMS which requires brokers to provide customers with the best possible execution available and provide protection to orders at the National Best Bid or Offer ("NBBO"). In response to Reg. NMS firms have developed complex technological systems capable of surveying trading venues to obtain optimal execution. In the two years since elimination of the uptick rule, equities markets have become significantly more complex. The number of trading venues, including exchanges, ECNs and ATSs has expanded from 10 in 2007 to more than 40 today. The markets have never faced the challenges of either a tick or bid test in a Reg. NMS environment as these price tests were eliminated prior to implementation of Reg. NMS. STANY doubts whether any of the proposed amendments can be effectively implemented without causing serious market disruption given the changes to the market since elimination of the original price tests.

As a result of Reg. NMS and the changes that immediately preceded and followed its implementation, a known tick or bid sequence does not exist. The Commission has acknowledged, that an uptick rule cannot be implemented unless there is a single place where executions occur and trades are reported sequentially.[10]This means that without reversing years of market structure reform, the uptick rule cannot be implemented.

Trading data is delivered to firms from multiple market centers where executions take place micro or milliseconds apart. The speed at which firms receive ticks and quotes can vary depending on a number of factors including the firm's location relative to the market center (proximity hosting vs. co-location), the speed of the network the firms are on, the market data delivery mechanism they are using and their bandwidth. These factors, plus the 90 second lag in trade reporting permitted under Reg. NMS, result in sequencing that does not reflect the actual sequencing of transactions. STANY members from two market making firms report that, although their firms are literally across the street from each other, and although both firms use the latest technology, the data that their traders see in any given millisecond varies greatly. All of this makes it virtually impossible to accurately monitor ticks and comply with an uptick rule; extremely difficult to discover violations of the rule; and easy for those who wish to circumvent the rule to do so.

THE MODIFIED UPTICK RULE AND CIRCUIT BREAKER PROPOSALS ARE ALSO FLAWED.

The modified uptick rule, which ties price movements to bids as opposed to sales (or ticks), is less difficult to monitor, but still carries with it much of the limitations of the uptick test. The proposed

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[10] SEC Release No. 34-34277, June 29, 1994.

exemptions and suggestion that the modified uptick rule be implemented as a policies and procedure rule, however, make the modified uptick rule easier to implement than the suggested uptick rule.

We caution however that both the uptick rule and the modified uptick rule assume that market participants have an idea whether there is an uptick or upbid at the time they enter an order to sell. Market data latencies impact bids as well as ticks. At the broker dealer level calculation of the National Best Bid ("NBB") can be done through proprietary feeds, through use of Securities Information Processor ("SIP") feeds or through a combination of both. Moreover, exchanges offer multiple feeds with overlapping data. All of this impacts what an individual broker dealer sees at any given point and whether a firm believes that the last bid was an up bid or down bid.

If the Commission's goal is to improve investor and issuer confidence, the modified uptick rule is particularly troublesome. The differences in timing and latency generally mean that a modified uptick rule can never be complied with except as a frame of reference for a particular firm.
This means that firms that are in compliance based on what they can see with their systems will in fact trade on a down bid from time to time. On any trading day, a review of the bid status when quotes were actually submitted as compared to what any firm thought was a down bid at that time, would likely show that the Street was not in compliance with what people think is the modified uptick rule. We seriously question whether the public (or Congress or the press) will fully appreciate the difference between a rule that prohibits submitting a short sale order on a down bid and a "policies and procedures" requirement that essentially requires a firm not to submit a short sale order when they think there is a down bid. Because public and governmental pressure appear to be the driving forces behind the SEC's proposed amendments, we fear that if the Commission institutes a modified uptick rule, it may make things worse as far as public perception is concerned.

The Commission's suggestion that firms take snap shots of market data when entering short sale orders so that they can rely on the broker dealer provision exemption will be difficult and costly to implement. Many broker dealers are not presently equipped to comply with this requirement. Even those who currently have systems that are able to snap quotes throughout the day to capture the current and last NBB at a particular time will likely need to expand their storage capacity. We understand that broker dealers will not be required to take advantage of the exemption, however, practically speaking, in order to remain competitive firms will need to have the capability to take and retain snap shots of the NBB. While we do not have a good estimate of the costs associated with this, we anticipate that it will be significant.

Our members have debated long and hard about the various proposals presented by the SEC as well as those presented by others in response to this filing. The industry has conducted roundtable and panel discussions, formed committees dedicated to consensus building, taken polls of industry participants and in numerous other ways discussed the pros and cons of each of the proposals. Recognizing that a flat out uptick rule and/or bid test would be difficult and costly to implement and enforce, and could cause serious damage to liquidity, we turned our attention to the Commission's Circuit Breaker proposals.

Circuit breakers have the advantage of limiting the impact of short sale restrictions to stocks that are experiencing extraordinary downward pressure. Because of the time limitation and the fact that circuit breakers are meant to be applied on a stock by stock basis, the negative impact on liquidity of a circuit breaker is less of a potential problem to the markets. We agree with the Commission that circuit breakers are preferable to strict price test restrictions in that they are easier to implement, less costly to program and limited to instances of unusual downturns in the market. However, the cost and implementation benefits of a circuit breaker will be mitigated if tripping of the circuit breaker triggers the application of a bid or tick test.

Although circuit breakers are preferable to either a strict uptick or modified uptick rule, they still fall short in terms of being effective regulation. We agree with the Commission's previous recognition that a circuit breaker should be used as an extraordinary measure. The Commission stated "In general….markets function best when they are open and unencumbered by artificial considerations like circuit breakers. For this reason, the Commission believes that mechanisms like circuit breakers, which impede the natural functioning of the markets, should only be imposed in the most extreme circumstances. …Circuit breakers were meant from their inception to be triggered only in truly extraordinary circumstances- i.e. a severe market decline when the prices have dropped so dramatically that liquidity and credit dry up and when prices threaten to free fall."[11]

While an amendment that includes a circuit breaker followed by a modified uptick rule will have the least negative impact on liquidity of the five amendments proposed by the Commission , we do not believe that there is a demonstrated need to this type of regulation. Moreover, the problems with the modified uptick rule will exist even if applied only after a circuit breaker is triggered. The issues of potential damage to liquidity, difficulties of implementation and compliance are only limited in time and scope when the modified uptick rule follows a circuit breaker.

<u>Any amendment which the Commission implements for NMS securities, should likewise be applied to securities traded in the over-the-counter ("OTC") markets.</u>

STANY agrees with the position put forth by Pink OTC Markets[12] that whatever rules the SEC deems necessary to prevent abusive and naked short selling in NMS stocks be applied with equal force and effect to securities traded in the OTC markets. If the Commission determines that NMS stocks require the protection of restrictions on short selling, then that same protection should be extended to OTC securities. If it is believed that protection is required, less liquid stocks and the stock of less capitalized firms that trade in the OTC markets are in need of as much, if not more, protection from manipulative behavior than NMS stocks. Moreover, failure to offer these same protections in the OTC markets could negatively impact the ability of firms whose stocks trade over-the-counter to attract purchasers and raise capital.

Likewise, from a systems and technology standpoint, it is more cost effective for a firm to program its systems to handle NMS and OTC stocks in a similar manner than to have different systems for each. It makes little sense from a cost, monitoring and implementation prospective to require firms to retool their systems only as they pertain to NMS stocks. Given that the Pink OTC Market has advised the Commission that in the event of the implementation of a bid test it will be ready, willing and able to join the current Tape C UTP network or work with FINRA to create an OTC/ITP plan including the best bid and offer prices for securities quoted in OTCBB and in the Pink Quote Inter-Dealer Quotation System, we see no impediment to application of a bid based rule to the OTC markets.

<u>It is important that any final rule restricting short sales include exemptions for bona fide domestic and international arbitrage, bona fide market makers and derivative and ETF market makers.</u>

As proposed, the uptick and modified uptick proposals include exemptions for bona fide domestic and international arbitrage. The Circuit Breaker plus Trading Halt proposal is the only one of the proposals which includes an exemption for derivatives and ETF market makers. None of the proposals include an exemption for equity market makers. We believe that it is critical that whatever final rule the Commission adopts include exemptions for these strategies and participants so hedging activity is not adversely affected and markets can continue to function effectively.

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[11] Securities and Exchange Commission, 72 Fed. Reg. 18479 (April 15, 1998)

[12] R. Cromwell Coulson, Chief Executive Officer, Pink OTC Markets Inc. May 26, 2009, available at http://www.sec.gov/comments/s7-08-09/s70809-2676.pdf, Internet.

Without an exemption, bona fide marker makers would not be able to maintain two sided quotes in securities unless they held sufficient inventory in those securities. Market makers would be forced to withdraw from the market if their inventories were exhausted. This is especially problematic in securities in which there are few market makers. An exemption for bona fide market makers would permit them to maintain two sided quotes and provide liquidity to the market regardless of whether their inventories were depleted.

Market maker and specialist exemptions were available under NASDAQ's old bid test and NYSE's old tick test. We see the Commission's decision to exclude this important exemption from the instant rule filing as a significant error. Lack of an exemption for bona fide market makers, as well as options market makers would seriously impact liquidity at the very times when the liquidity that market makers provide is most needed to maintain orderly markets. We are fearful that the lack of these exemptions would have the unintended negative consequence of causing market makers, especially in smaller less liquid stocks, and options to drop out of the market, or cease making markets.

In order to effectively carry out their obligations and maintain orderly markets, firms acting as market makers or specialists absolutely require an exemption from price and circuit breaker limitations on short sales. If the Commission is worried about abuses, rather than not including such an exemption, it could define under what conditions a market maker exemption would be available and appropriate. We would suggest that if a firm is acting in the capacity of a bona fide market maker, with all of the obligations (maintaining continuous two sided quotes) and regulatory scrutiny attendant to market makers then an exemption should be available. As FINRA and the SEC both have regulatory authority over broker dealers, these regulatory bodies should be able to ensure that market makers and specialists use the exemption for the purposes of market making activities and that the exemptions are not abused. Although other providers of liquidity arguably add value to the markets, they stand apart from market makers in that they do not have similar obligations. The obligation to maintain a two sided market should be encouraged and facilitated by an exemption which would permit the selling short of a security even if (and at a time when) other market participants are precluded or limited from doing so.

Failure to include a market maker exemption would have even greater impact in the options markets. As discussed above, an exemption is especially critical for options market makers where short selling is necessary to facilitate options strategies and hedge against risk. Without an exception it is likely that many options market makers will cease to make markets.

<u>Any amendment to Reg. SHO should be introduced through a pilot program.</u>

The Commission should move carefully with respect to rule changes which could have a negative impact on liquidity. Any such changes should be supported by evidence of their effectiveness. Likewise, if a price test based on upticks or upbids is reintroduced, we believe that more time will be required than the three month integration period suggested in the rule filing. We anticipate that the systems work will involve difficulties and costs not dissimilar to those experienced with the integration of Reg. NMS. Technological changes may be even more costly and difficult. Amendments to Reg. SHO should not be implemented unless the Commission truly has reason to believe that the amendments will bring substantial benefits to the markets, which so far has not been demonstrated.

A pilot program will allow the Commission to access the efficacy of the amendment to Reg. SHO in a Reg. NMS environment and determine if the costs and difficulties of implementation are supported by a positive change in the functioning of the markets. A pilot will also allow the Commission to monitor the impact of the selected rule on liquidity, spreads and trading costs. If a permanent rule is implemented without a pilot and the rule is shown to negatively impact liquidity, it will be measurably more difficult to eliminate the rule than if the rule is properly tested in a pilot program.

Prior to a final rule implementing one of the Commission's five proposed tests, the Commission should give serious consideration to alternative ways in which to address perceived problems with short sales which have been proposed in response to this rule filing.

Several letters have been written in support of alternative regulation aimed at curtailing fails to deliver. For example, it has been suggested by STA[13], Overstock.com[14], and FlexTrade Systems, Inc.[15] that the Commission's goals would be better served by implementing rules relating to the locating and borrowing of securities. Although slightly different in their iteration, these proposals all seek to focus attention on locate and borrow requirements of Rule 203 and 204T. Although we have some questions about the current facilities to locate stock, if properly implemented stricter regulations on borrowing securities could provide transparency to an area of the industry that is largely non-transparent at present. Additional discussion and evaluation of these different proposals would be required, but given that they would not appear to negatively impact liquidity and that they are more likely to address the real issues with short sales, we believe it would be worthwhile for the Commission to consider these approaches if it deems additional regulation is warranted. We would add, however, that a market maker and options market maker exemption should be made with respect to any rules regarding pre-borrows.

Summary

STANY respectfully requests that the Commission not amend Reg. SHO and not implement any of the suggested proposals. A limitation on short selling will not address any real issue and is likely to create problems such as decreased liquidity and wider spreads. Short selling is a legitimate and useful market tool. Naked short selling and market manipulation on the other hand are harmful. Rules already exist to address naked short selling and market manipulation and the proposed amendments will have little, if any, effect on those already proscribed violations. The markets would be better served by enforcement of those rules than by implementation of a rule which is likely to be difficult and costly to implement and is unlikely to have the desired effect of either eliminating naked shorting or increasing investor and issuer confidence.

If the Commission is intent on amending Reg. SHO, then the Commission should make changes that are the least burdensome and that provide the greatest possible benefits at the lowest possible costs. The circuit breaker proposal followed by a modified uptick rule would seem to meet those requirements. However, we caution that while implementing an unnecessary rule change may placate unhappy investors, worried issuers and Congress in the short term, ineffective regulation will, in the long run, benefit or satisfy no one.

We suggest that before implementing any of the proposals in File No. S7-08-09, the Commission give serious consideration to regulation focusing on the real issues with short selling- naked shorting. The Commission should make Rule 204T a permanent rule and should consider whether additional requirements on pre-borrowing securities would be beneficial.

[13] Peter J. Driscoll, Chairman and John C. Giesea, President and CEO, Security Traders Association, May 4, 2009, available at http://www.sec.gov/comments/s7-08-09/s70809-425.pdf, Internet.
[14] Patrick M. Byrne, Ph.D., Chairman and Chief Executive Officer, Overstock.com, Inc., May 29, 2009, available at http://www.sec.gov/comments/s7-08-09/s70809-2850.pdf, Internet. Although Overstock.com does not oppose reinstatement of the uptick rule, they recognize that a focus on settlement of trades, disclosure of short sale positions, and enforcement would be a more effective in stopping manipulative short sales.
[15] Vijay Kedia, President and CEO, FlexTrade Systems, Inc. June 3, 3009, available at http://www.sec.gov/comments/s7-08-09/s70809-3263.pdf, Internet.

If the Commission implements one of the five proposals in this filing, the implementation should be done on a pilot basis to ensure that the amendment in its practice is compatible with Reg. NMS. Likewise, any negative impact on liquidity and spreads should be studied during a pilot. In the alternative, we would suggest that whatever restrictions are imposed include a sunset provision. That way, if the real goal is investor confidence, limitations on short selling could expire at some point in the future when confidence is deemed to have been restored.

We also suggest that any amendment be applied equally to the OTC markets. If it is determined that there is a valid need for an amendment to Reg. SHO, that need will likely be as great, if not greater, in the OTC markets than in the market for Reg. NMS stocks. Investors and issuers in the OTC market should be given the same protections as those deemed necessary to investors and issuers of NMS stocks.

Lastly, any amendment should include an exemption for bona fide market makers and option market makers. Without an exemption, those liquidity providers will be unable to render valuable service to the markets. The potential negative impact to liquidity, especially in thinly traded stocks and options should not be underestimated. The obligations on market makers and options market makers to maintain orderly and liquid markets require the flexibility that comes with a short sale exemption.

We are aware of the difficult task with which the Commission is faced and know that it will not be easy to dismiss the sheer number of comments that call for “reinstatement of the uptick rule.”: However, we trust that the Commissioners, will discharge their obligations based on empirical evidence and independent of political or public pressure and do what they understand to truly be in the best interests of the US markets. In this regard, we respectfully call your attention to the letter sent to SEC Chairman, Mary Schapiro, yesterday, June 17,2009, by Senators Crapo, Bunning, Vitter, Enzi and Martinez whose sentiments we echo and applaud. Indeed, our members would be interested in the seeing the OEA and Commission’s responses (and any supporting studies or empirical data) to the questions raised by the senators. We sincerely hope that the Commissioners will consider the recommendations and comments submitted in this letter and the wisdom expressed in the letter from members of the Senate Banking Committee and thank the Commission for the opportunity to present the views of our members.

Respectfully submitted,

Kimberly Unger
Executive Director

United States Senate

WASHINGTON, DC 20510

June 17, 2009

Mary Schapiro
Chairman
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Dear Chairman Schapiro:

As the Commission considers imposing restrictions on short selling, we would encourage you to base the decision on empirical evidence. Shifting the SEC's approach to rulemaking from relying on quantitative economic analysis to an emphasis of market psychology would be a significant departure and raise many questions. The practice of short selling evokes strong opinions from both its supporters and detractors, and any final decision must be able to withstand scrutiny and cost-benefit analysis. In late September of 2008, the Commission banned short sales on about 900 financial institutions without economic analysis. The general view was that it added to market confusion and did not do much to halt the slide in financial stocks. The then Chairman of the Commission subsequently characterized this action as the biggest mistake that the SEC made during the financial crisis.

In June 2007, the Commission unanimously voted to repeal the uptick rule, which was adopted in 1938. It did so after the Office of Economic Analysis (OEA) conducted an eight-year review of the rule that sought public comment on short sale price test regulation, including whether to eliminate such restrictions. After gathering the data, analyzing the data, and providing a summary report on its findings, OEA did not find evidence that the pricing restrictions reduced short interest, but did conclude that the pricing restrictions distorted the trading process.

During the May roundtable, you stated that any short selling restrictions must balance the goal of helping to prevent abusive short selling with the view that legitimate short selling can provide tangible market benefits such as improved liquidity and pricing efficiency. Since the SEC's past studies showed the uptick rule's ineffectiveness and because the benefits of short selling in fostering liquid and transparent markets are widely recognized, please explain the steps that OEA has taken and is taking to analyze each of the proposals to determine whether there would be a net benefit from imposing an additional short selling restriction and, if so, which proposed restriction would generate the greatest benefit at the lowest cost. What conclusions has OEA reached with respect to the net benefits of each proposal? How will the Commission take into account OEA's analysis and the economic literature on the benefits of short selling and the costs of restrictions on short selling? What are the potential unintended consequences in a Regulation NMS world of implementing an uptick or bid test? The Commission has taken a number of important steps to stop abusive short selling and "naked" short selling. Specifically, Rule 204T has been effective at reducing naked short sales, and has resulted in a clear reduction in failures to deliver. Instead of imposing blanket restrictions that will negatively impact liquidity, price discovery, and spreads, the Commission should focus on specific abusive trading conduct that is clearly defined and provides measurable results.

Thank you for your attention and we look forward to your response at your earliest convenience.

Sincerely,

Mike Crapo   Jim Bunning

David Vitter   Michael B. Enzi

Mel Martinez

cc: Commissioner Kathleen L. Casey
Commissioner Elisse B. Walter
Commissioner Luis A. Aguilar
Commissioner Troy A. Paredes