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Association

June 19, 2009

The Honorable Mary L. Schapiro
Chairman
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

RE: Release No. 34-59748: File No.S7-08-09;
<u>Proposed Price Test Amendments to Regulation SHO</u>

Dear Chairman Schapiro:

The Security Traders Association (STA or the "Association") welcomes the opportunity to answer questions the Securities and Exchange Commission (SEC or the "Commission") poses regarding SEC File 34-59748, Proposed Amendments to Regulation SHO.

The STA is a professional trade organization that works to improve our markets, ethics, business standards, and the working environment for our members. There are approximately 5,200 members across North America, all engaged in the buying selling and trading of securities. Members participate in STA through 27 affiliate organizations and represent the interests of the trading community and institutional investors. The STA provides a forum for our traders, representing institutions, broker-dealers, ECNs, and floor brokers to share their unique perspective on issues facing the securities markets. Our members work together to promote their shared interests in efficient liquid markets as well as in investor protection.

The STA has been involved in the short sale discussions for decades. Our members are actively involved in the business of trading securities and are therefore uniquely qualified to discuss regulations concerning the purchase and sales of securities. We are in fundamental agreement with the SEC that short selling is a legitimate and economically important activity that fosters price discovery and provides additional liquidity to the markets. The STA supports legal short selling as a critical component of overall liquidity. We applaud the Commissioners for focusing on balancing the costs and benefits of any additional short selling restrictions at both the April 8, 2009 open meeting and the May 5, 2009 Roundtable. We support strict enforcement of locate and delivery rules that eliminate illegal and abusive short selling, including naked shorts.

420 Lexington Avenue • New York, NY 10170 • tel (212) 867-7002 • fax (212) 867-7030 • traders@securitytraders.org • www.securitytraders.org

The STA communicated our concerns about "tick tests" and "bid tests" on many occasions in the past. We believe that these price tests have been rendered ineffective by structural changes in the markets and price tests would be unable to dampen volatility even if they were to be reinstituted. The STA believes that an objective means of establishing benchmarks for these tests does not exist in today's market structure. We believe that both tests are seriously flawed and if they are implemented, gaming of these trading restrictions will become rampant. Neither price test would present any appreciable obstacle to abusive short selling in downward spiraling issues and would be ineffective in solving the current quandary. The STA believes rules should be promulgated to control identifiable and measurable problems, and does not believe that reincarnating ineffective regulations of earlier markets will position us to effectively compete in today's markets.

The Association believes the most effective way to prevent abuse is strict enforcement of Regulation SHO. There is no substitute for vigorous surveillance, examination, and investigation of short selling to combat abusive trading practices by a few. Effective regulatory oversight does more to reduce the amount of naked short selling than any one rule or set of regulations.

We believe that clearing and settlement is the appropriate area to concentrate short sale regulations. Temporary Rule 204T is succeeding in reducing fails to deliver and needs to be made permanent. While we support the effort to highlight potential liability for failing to locate securities to make delivery on short sales, our support for proposed Rule 10b-21 would be stronger if naked short sales were formally defined and fewer ambiguities existed with the locate requirement. We believe in the value of undertaking the effort to locate the securities, but as the requirement reads now, the Association has great concern for the potential liability for its members and their customers. We note the ambiguities in our recent *Special Report: The STA's Perspective on U.S. Market Structure* (May 2008). Specifically on page 18 of the Special Report we say:

Footnotes in the Regulation SHO release and the responses to the SEC's frequently asked questions, which address how broker-dealers satisfy the "locate requirement" under Rule 203(b)(3), serve to create more uncertainty. These interpretations seem to allow registered broker/dealers to rely on other entities, some of which are not registered with the SEC, for their performance under the rule. These non-registered entities have become some of the broker/dealers largest customers making it more probable that the broker/dealer would readily accept any assurances provided to them.

We believe that current regulations will be sufficient to curb abusive short selling if those rules are strictly enforced. STA offers the Commission an alternative circuit breaker proposal which would allow nearly full price discovery while placing additional burdens of regulation upon those who participate in short selling. We urge you to closely examine our proposal, submitted to the Commission on May 4, 2009.

Our answers to questions asked by the Commissioners at the May 5, 2009 Roundtable and selected questions from the proposing release follow:

Market Changes and Investor Confidence: Are short sale price tests or short sale circuit breakers necessary or effective?

Commissioner Casey: Please give your best view of the effectiveness of the old uptick rule. Rick and others have spoken of the amount of focused study that the Commission has engaged in, looking not just internally at some of the analysis through the pilot program, but also at 13 other empirical studies and data that were collected that ultimately supported the Commission's decision to remove the uptick rule. But I'm more interested in 1) whether or not you believe the uptick rule was effective, given what we know about the changes in the function and structure of our marketplace over the past several years, and then, if you don't believe it was effective, then why do you think there were so many calls for us to reinstate the old rule, begging the question of the fact that we are actually proposing different price tests here, that would be effective in this marketplace, and if that is the case that they weren't effective and folks were calling for us to reinstate it knowing that it wasn't effective, how would that actually increase investor confidence? Any data or analyses you could point to would be helpful.

1) whether or not you believe the uptick rule was effective, given what we know about the changes in the function and structure of our marketplace over the past several years

STA has long held that short selling enhances overall liquidity and represents a valid investment alternative. Historically, short selling was much easier on the NASDAQ market because there were multiple market makers trading the security, any one of which could create an uptick at any given time. We will therefore illustrate our point using the NYSE environment. The NYSE uniquely had a specialist in command of the trading of each security listed on the exchange, tasked with the responsibility of keeping fair and orderly markets. The single specialist system, the exchange's dominant market share and the strict "tick test" allowed the specialist near total control of trading and thus prices. Also, equities were traded in fractions of 1/16 of a dollar, so each price increment was worth 6.25 cents.

The introduction of penny pricing (moving from trading in fractions of 1/16 to decimals) in 2001 reduced each price increment to only one cent, resulting in 6.25 times as many price points. The specialist had a much more difficult time controlling price and thus short sellers. The advent of Regulation NMS in 2005 and its proclamation that markets must be fast to effectively participate in the national market system further eroded the control that the specialist enjoyed. It was too difficult for a specialist to control a market when trades were occurring in sub-second intervals. The fast market requirement has also allowed NYSE competitors to take a good deal of market share from the NYSE, thus fragmenting the market, further reducing the control of the specialist and allowing more short selling at more venues and price points. The role of the specialists has so deteriorated that the NYSE has eliminated them and replaced them with Designated Market Makers who have far fewer market making obligations.

Market professionals have long known strategies that allowed them to establish positions equivalent to short sales without regard to any price test. For example, if participants desired a short position in a sector of the market, Exchange Traded Funds (ETFs) (i.e. the Biotech Holders provides exposure to the biotech group), futures products (i.e. the S&P 500 Futures traded at the Chicago Mercantile Exchange (CME) and index options products (SPX S&P 500 index options or the DJX Dow Jones Industrial Average Index Options traded at the Chicago Board Options Exchange (CBOE)) allowed this exposure and did not require any price test. If exposure to a specific equity security was desired, the participant merely needed to purchase put options or sell call options on the desired security.

The SEC recognized the flaws that had rendered the price test rules obsolete and proactively attempted to formulate rules that could effectively prevent abusive short selling. Regulation SHO was the result of those efforts. Recognizing that focusing on price constraints or even trading constraints in a one-hundred price point sub-second, fragmented trading environment would be futile. The Commission concentrated on how to efficiently constrain short selling on the issuer and back-office side of the equation while removing the ineffective price tests. Regulation SHO was promulgated following much industry and academic comment. It was also implemented incrementally with a year-long pilot period during which the effects of removal of price tests was carefully studied. No detrimental effects were identified during the pilot period.

2) and then, if you don't believe it was effective, then why do you think there were so many calls for us to reinstate the old rule, begging the question of the fact that we are actually proposing different price tests here, that would be effective in this marketplace, and if that is the case that they weren't effective and folks were calling for us to reinstate it knowing that it wasn't effective, how would that actually increase investor confidence?

We believe that many of the calls for reinstatement of the uptick rule come from those who are not intimately familiar with market structure. Many of the letters that the Commission has received ask the Commission to reinstate the uptick rule to end the problem of naked short selling. While we believe that naked short selling needs to be eliminated, we also know that the uptick rule would have little or no effect on the naked short selling problem. Another group of letters came from individuals who were active in the securities industry several years ago. Most of these commenters fail to recognize the many changes to market structure that have occurred since their departure. Decimalization, technological advancements and decentralization of the markets (described above) have changed how market participants interact and conduct business in such a way as to make the uptick rule difficult to comply with and unenforceable and thus ineffective.

Another group of participants calling for reinstatement seem to be trying to deflect attention from their performance during the current market turmoil. It is certainly easier to focus an investor's attention upon an esoteric rule, demonize the rule and call for its removal and then cry manipulation rather than defend an investment manager's inaction or a stock pick that went awry (especially when those calls may have been distributed in mass media form). The STA believes that this is a time to promote what is best for the markets and not profess those beliefs that are only in one's pecuniary interest.

As securities traders, STA members are responsible for executing transactions for and providing liquidity to the American investor. The STA represents the shared interests of approximately 5200 members, all engaged daily in the purchase and sale of securities, who belong to one of our 27 national and international affiliate organizations. Our members work for broker-dealers, investment managers and trading venues, virtually every business model in our industry. We are actively involved in the business of buying and selling securities and are therefore uniquely qualified to discuss the rules and regulations concerning the purchase and sales of those securities.

Chairman Schapiro: I recognize that we don't want to react to every market up and down but we do want to make sure that we are being highly responsive to fundamental changes in our market. This discussion leads me to wonder whether, even if the old uptick rule perhaps had become pretty ineffective because of market structure changes, because of high frequency traders that you all talked about changes and therefore the old uptick rule was perhaps not doing what we hoped that it would do. Doesn't that suggest that maybe it should have been replaced with something else that was more effective in the new market structure and that's what we're trying explore here is given all of these other changes what might replace the old uptick rule or what else might act as a governor on abusive short selling in these new markets with high frequency traders, with 40 different places to send your orders, with the great amount of fragmentation that we have today and with the technology that allows this tremendous speed of execution?

While the STA understands the Commission's desire to be responsive to fundamental changes in our markets we have long held that our financial markets cannot function efficiently when rules and regulations are changed in the heat of the moment. In our current environment of exceedingly interconnected markets, even seemingly very minor changes can have disastrous unintended consequences. Rushed rulemaking and accelerated compliance requirements increase the likelihood of unintended consequences. It is important to note that the equity markets were literally the last functioning frontier of liquidity during the financial crisis. It was the only market that was not frozen by fear.

Observations that short selling abuses could and should be addressed by concentrating on the enforcement of rules on the clearing side of the business have clearly been validated. The SEC implemented Rule 204T in September of 2008 on a temporary basis. This rule has had an amazingly positive impact on the problem of naked short selling, reducing the number of stocks on the threshold lists from over 500 companies last July to eight operating companies recently. Rule 204T has been successful because it imposes potentially severe economic sanctions on market participants who allow fails to deliver to persist. The STA would fully support making Rule 204T permanent.

The markets have completed the costly transformation to "fast" markets required by Regulation NMS, the slow manual markets have been permanently replaced. Price tests just won't work in a penny-wide decentralized electronic marketplace. We believe that it is more appropriate to attempt to accomplish the goals of regulation without disrupting the natural interaction of supply and demand or price discovery as much as possible. In that vein, the Security Traders Association offered an alternative circuit breaker proposal in our May 4, 2009 comment letter. While we firmly believe that the current regulatory regime enforced aggressively would do plenty to curb any abuses, we offered our circuit breaker pre-borrow proposal in an attempt to align any additional short selling regulatory burden with those participating in that segment of the market while maintaining robust and unencumbered price discovery. The circuit breaker pre-borrow proposal is more than a mere processing mechanism that can be easily circumvented, it actually changes the risk/reward profile of the short sale by increasing the cost of making the short sale. Short sellers with conviction in their strategy will pre-borrow the securities to be sold, but short sellers with less certitude will be reluctant to execute the strategy.

Commissioner Walter: As I listen to all of you speak… I hear a tension between two positive things: a desire to have the price of a particular security be what it should be and really represent the value of the underlying company and a desire not to interfere with broader trading strategies which involve but don't center around any particular security. I wonder if you have a comment on, if you'll accept that as an assumption for a moment or perhaps comment on it, and whether that tends to lead towards a less rather than more extreme reaction, perhaps to a circuit breaker kind of approach and if that's correct whether the effectiveness of that approach in turn is undermined either by what has been called the magnet effect or by a build-up of short selling interest that builds during the period when whatever follows the circuit breaker is in effect?

The STA believes that interfering with the robust and transparent price discovery process only leads to artificial prices for securities. Regulations should be designed to curb inappropriate behavior while encouraging the most robust price discovery possible. None of the proposals set forth in this release meet those criteria. These proposals deliberately denigrate the price discovery process in an attempt to increase investor confidence. It escapes us how offering less efficient price discovery would restore their faith in the markets.

Broader trading strategies generally work best when the underlying assets are fairly priced. When the underlying assets are mispriced, market participants buy the cheaply-priced index and sell the over-priced basket of underlying assets bringing the prices back in balance. Restrictions on when the underlying assets can be sold hamper the efficient functioning of the markets.

There has been a great deal of discussion centered on the U.S. Markets long experience with circuit breaker rules. NYSE rules 80a and 80b are often cited and there is a good body of academic study suggesting that a mild magnet effect accompanies these types of regulations in developed markets. These rules are fundamentally different than the circuit breakers proposed in the proposing release. Rules 80a and 80b deal with market-wide halts, whereas the rules that are being proposed deal with single stocks. When the general market experiences dramatic drops without any fundamental news, it is rational to believe that a trading halt would allow rational pricing to return. In the case of an individual issue, some investors may have legitimately discerned problems at the company that are not as yet widely reported. In this scenario, the investor who possesses the unreported information will sell as much overpriced stock as possible, in the fastest manner possible in an effort to capitalize on their informational advantage. Here, the rational price is the lower price and after the halt is lifted selling pressure will resume either unabated, or more robustly if the halt alerts other participants to the problem. The magnet effect will be extreme and the velocity of the issue's decline would be increased pronouncedly.

Commissioner Paredes: Another way of getting at the balancing act here is trying not to be over inclusive right? You weed out the "bad stuff," and we can debate what's bad, and you let the good stuff in, and we can debate, I guess at the margin, what's good. One way of addressing that is a circuit breaker type of a concept, another way of addressing that is by making sure you have the right exemptions in place. So, I was wondering if you could speak to the exemptions that were offered up as part of the proposal, or at least some of them, but if there is anything in particular that you think we may be missing that would be particularly important to add to the mix.

In our 2008 *STA Special Report: The STA's Perspective on U.S. Market Structure,* we discussed the conundrum of rules that require multiple exemptions and exceptions:

The STA is of the opinion that a marketplace without this order protection rule will be superior to enforcing the current OPR with its approximately seventeen exemptions…. While the OPR was well intended, its many complex exemptions complicate compliance and dilute its effectiveness. The specific nature of each exemption matters less than the fact that their creation was necessary.

The STA believes that market maker and options market maker exemptions are important and necessary. In the proposing release, however, it takes three pages to describe these exemptions. As it is defined in the proposal, all traders entering orders to buy and sell the same security would qualify for an exemption. We believe that the offered definition is overly inclusive and ripe for gaming. Market maker exemptions were designed to provide relief to market making participants who had SUBSTANTIAL OBLIGATIONS to the market, which could be encumbered by the short selling rules. The STA believes that only those who have these obligations should be allowed to avail themselves of these exemptions, and then only when the obligated participants are engaged in bona fide market making required by these obligations. The current robust definition of market maker needs to be whittled down so that nearly one in four shares traded does NOT qualify for this exemption, as was the case during the emergency short selling ban of September and October**.**

In a single stock circuit breaker regime we would also question the necessity to have the last half hour exempt from the rule. We have heard the argument that some participants may need to make a short sale in the last half hour to "flatten" out their positions and go home positionless to avoid overnight risk, as many of today's market participants do. On further examination of that argument, however, we would note that making a short sale is only a way to enter a position. If one were to be selling to "flatten" the position, he or she would own the shares needed to sell and thus be long sellers.

The STA would also note that the final half hour of the day has become the most volatile part of the day. While we do not believe that any of the proposed rules will accomplish this goal, this is exactly the time that a rule that would slow short selling and reduce volatility would be most needed.

Director Brigagliano: You know the need for exceptions ties into the power of the restrictions and I know, Dan, you pointed out the concerns about a ban with respect to liquidity, but several of the panelists have also said that the uptick rule wasn't effective at all so I guess I'd ask you, Dan, how much of a restriction would the price test proposed by the Commission be, I hear you talk about the need for exceptions, but how much would short sellers be restricted by a price test at the trading increment?

Great point Director Brigagliano. The STA does not believe that the proposed rules would have any negligible effect on short sellers in a minimum price variation market. We have mentioned that these sellers will be able to make their sales scores of times every minute in active stocks. Long sellers would then be forced to create the downward pressure on the stock because of built-up supply sitting on the offering side.

The real trouble with these proposed regulations, as we have mentioned, is that we would be enacting these regulations as the prescription that will cure the abusive short selling problem. It will not, and investors will soon realize this, when the next wave of corrective selling occurs based on the simple economics of supply and demand. Supply overcomes demand when market pricing suddenly does not properly reflect the underlying fundamental valuation of a company, an industry or an asset class based on a dynamically changing set of factors. What will the Commission do then? It will be too late to begin the investor education initiative that many of the comment letters illustrate is needed. It will be too difficult to enforce the new regulations and produce a short-term confidence boost. The likely outcome of implementing any of these proposals would be a further deterioration of investor confidence, exactly what we do not need.

Commissioner Casey: I think John mentioned earlier the relationship between extreme market volatility and investors' perception of market quality and integrity and ultimately their confidence in the markets. I was hoping that any of you could share your experience over the past eight months on what you believe the key drivers were of the volatility that we have seen in the market, particularly short selling. And then, also help me understand how much of a role programmatic trading plays in driving volatility.

In our May 2008 *Special Report: The STA's Perspective on U.S Market Structure*, we noted:

The U.S. equity markets are currently experiencing volatility not seen recently. Underlying changes in market structure over the last decade have contributed to the current market volatility. Specifically, the increase in funds seeking short-term performance; the growth in the use of derivative products; new technologies; the pervasive use of algorithmic trading and quantitative models; and the reduction in the *role of specialists and market makers have all contributed to the volatility we are currently experiencing. Current volatility is not unprecedented, the speed with which markets move today is.*

We would direct the Commission to pages 4 through 9 of that Report for a much more in-depth discussion of the current drivers of volatility and velocity in our current markets.

There are many different types of program trading: arbitrage, portfolio rebalancing and cash raising strategies, to name a few. Many of these strategies have absolutely no relationship to the short selling problem. However, a good deal of the selling pressure experienced over the last 18 months was related to these strategies, hedge fund de-leveraging and investors raising cash in particular. The STA believes that recent price declines and investors current passion for cash and liquidity during this period are a function of uncertainty and difficult economic times.

Chairman Schapiro: One of the virtues, I think, of the Commission having put out so many different alternatives a couple of weeks ago is that we've seen some fairly creative comment letters come in that even give us some more choices and some combinations of choices of the things that the Commission proposed. So for example, I'd love to hear your thoughts on, if we were to go down the circuit breaker route, when the circuit breaker kicks in should it kick into a halt? Should it kick into a price test of some sort? Or should it kick into a pre-borrow requirement or should it kick into something else? If you have any ideas on that I'd love to hear them.

Thank you for the compliment, Chairman Schapiro. As the Chairman is aware, the Security Traders Association has offered an alternative circuit breaker proposal which would trigger a pre-borrow requirement. Any short sales subsequent to the breaker triggering would be required to have a bona fide borrow prior to execution of the short order. We are aware of some industry discussions condemning this proposal as too costly or not realistic in the current stock loan marketplace and having unintended consequences.

The whole idea behind the pre-borrow requirement is to change the risk/reward profile of the trade. Unfortunately, many market participants only look at their pecuniary interests when analyzing market opportunities. Changing the economics of the trade is the only effective way to dissuade them from executing a trade. Execution procedures and market mechanics are merely challenges in the execution process: changing the economics will change the profit motive and thus affect trading decisions.

As for this proposal being unrealistic in the current marketplace, our investigations have shown us that it is not only feasible, but we are aware that some large hedge funds have already chosen to pre-borrow securities to avoid problems associated with the current locate system and to ensure that their short sales will not be truncated during the settlement process. We are also aware that the Commission has recently been shown some innovative technological solutions to these objections. It seems to us that a great deal of work has been put into making the stock lending market more efficient and the objections the Commission may be hearing may be coming from entrenched interests that may not benefit from efficiency.

As a matter of fact, while the STA was developing this proposal, advances in market efficiency and greater market transparency were the two top unintended consequences identified. We believe that it is important to introduce technology solutions and transparency to the clearing and settlement process supporting short selling.

Answers to Selected Questions from the SEC File 34-59748 Proposed Amendments to Regulation SHO

Q: We recognize, however, that issuers of securities quoted in the OTC market may believe that they are particularly vulnerable to abusive short selling. Thus, we seek specific comment regarding whether the proposed modified uptick rule or some other form of price test, or any other restrictions on short sales, should apply to these types of securities.

A: The STA recognizes that many of the perennial complaints about manipulative short selling center around OTC and pink-sheet listed securities. While we applaud the efforts of *Pink OTC Markets Inc.* to bring more transparency to this market, we are not certain that this market is robust enough to withstand additional regulations that we believe would be ineffective and unenforceable. As discussed below, we believe that aggressive enforcement of existing Rule 204T, especially if combined with effective manipulation and rumor-mongering detection and enforcement, will adequately address naked and abusive short selling.

Q: In addition to the questions set forth above, commenters are welcome to offer their views on any other matter raised by the proposed amendments to Regulation SHO. Specifically, are there any other possible restrictions on short selling that the Commission should consider, particularly ones that might be helpful in a severe market decline?

A: The STA offered an alternative circuit breaker proposal in our comment letter dated May 4, 2009. We believe aggressive enforcement of the current regulations is all that is necessary. We offer our circuit breaker pre-borrow proposal to place any additional regulatory burden the SEC believes necessary on those participating in that market and to ensure these regulations do not interfere with robust and unencumbered price discovery. The circuit breaker pre-borrow proposal cannot be circumvented easily and it properly changes the risk/reward profile by increasing the cost of attempting to make the short sale. It could be an important and valuable addition to the regulatory structure governing short sales.

<u>Questions Regarding Proposed Short Sale Price Tests Generally</u>

1Q. Should short sales be subject to a short sale price test restriction, or should we continue to rely on current short sale regulations and anti-fraud and anti-manipulation provisions of the securities laws to address potentially abusive short selling?

A. No, short sale price test restrictions should not be imposed. The STA believes that price tests (such as the “bid test” or “tick test”) have been rendered ineffective by structural changes to the markets. Price tests will not reduce volatility if they are reinstituted. The markets have completed the costly transformation to “fast” markets required by Regulation NMS, the “slow” manual markets of the past are obsolete and gone. We ask and caution the SEC to avoid promulgating rules that will be difficult to comply with, will be expensive to implement, and which we believe will be unenforceable and ineffective. We are also concerned that great harm could befall investor confidence if rules are adopted which cannot be complied with, are unenforceable and would be ineffective if implemented.

Rather than impose new “old” regulatory restrictions like tick tests, more attention should be paid to enforcing existing regulations. The existing rules on short sales and market manipulation have sufficient breadth to address legitimate questions being raised about possible manipulative short selling. The remedy for inadequate enforcement is not to layer additional regulations on legitimate activity. In most cases, short selling has a legitimate financial and economic purpose and is conducted in compliance with the rules that regulate it. Attention should be focused on more robust and aggressive enforcement of existing rules against clearly abusive short selling practices.

2Q. We note that our decision to propose a short sale price test was based, in part, on the recent changes in market conditions and investor confidence. To what extent, if any, would a short sale price test, such as the proposed modified uptick rule or the proposed uptick rule, be necessary or appropriate in light of recent changes in market conditions? Please explain and provide empirical data in support of any arguments and/or analyses. How would the proposed modified uptick rule or the proposed uptick rule affect market conditions today? Please explain and provide empirical data in support of any arguments and/or analyses.

A. The Security Traders Association shares the concern of regulators about the effect recent precipitous and rapid equity price declines have had on investor confidence. Many have commented that the reimposition of a price test will "slow" the declines and restore investor confidence. The STA does not believe empirical evidence establishes this causal relationship. In fact two SEC studies indicate: 1) that the "uptick rule was less effective when it was needed most, during panics that drive markets down and volatility up;" and 2) "that short sales are more common during rallies than declines."

It is not the mission of regulators to influence the direction of prices in the markets. This could be the consequence of adopting price tests that inconsistently slow down trading in markets after the SEC adopted Regulation NMS mandating "fast" markets for participation in the national market system.

The view that a price test would reduce selling pressure in the markets was discredited by the experience of the recent emergency orders banning short selling of financial stocks. A review of trading patterns after the emergency order indicated that it was ineffective and failed to accomplish the goal of supporting prices by reducing selling pressure. Prices for financial stocks subject to the short selling ban lost 17.7% (including the artificial rally caused by the rushed implementation of the emergency short sale ban) during the ban period, as compared to the loss of 18.4% for the S&P 500 during the same time. If an absolute ban on short selling failed to stem the tide of selling pressure, how effective could a prohibition of short selling on down ticks be?

3Q (1). How effective would the proposed modified uptick rule or the proposed uptick rule be in allowing relatively unrestricted short selling in an advancing market? Please explain and provide empirical data in support of any arguments and/or analyses.

A. The proposed rules would allow unrestricted short selling in both advancing and declining markets. A "speed bump" restriction of a minimum price variation would be crossed hundreds of times a minute in active stocks allowing short sales every time the stock crossed to the offer or for that matter any time it moved above the bid.

3Q (2). How effective would the proposed modified uptick rule or proposed uptick rule be at helping to prevent short selling, including potentially abusive or manipulative short selling, from being used as a tool for driving the market down or from being used to accelerate a declining market by exhausting all remaining bids at one price level, causing successively lower prices to be established by long sellers? Please explain and provide empirical data in support of any arguments and/or analyses.

A. While these proposals could restrict short sellers from "hitting the bid" that would not slow short sellers appreciably and they would not inhibit long sellers in any way. Thus, once an initial short position is established, the short seller could encourage long sellers to sell a stock down by posting large offerings. The short seller reaps the rewards of the initial trade without having to make additional sales or risk as much money.

3Q (3).Could the proposed modified uptick rule or proposed uptick rule be modified to better meet these goals? If so, how? Please explain and provide empirical data in support of any arguments and/or analyses.

A. As we have previously stated, price tests will be ineffective in the current market structure. The SEC has found effective solutions to the abusive short selling problem on the clearing and settlement side of the equation. We believe that this is the appropriate solution and the Commission should continue to tighten locate and borrow rules to further eradicate this perceived problem.

4Q. We also note our concern regarding investor confidence based on the numerous requests for reinstatement of short sale price test restrictions. Would reinstating a short sale price test restriction such as the proposed modified uptick rule or proposed uptick rule help restore investor confidence? If so, why? If not, why not? Please explain and provide empirical data or other specific information in support of any arguments and/or analyses.

A. Rules should be promulgated as effective solutions to real problems. They should not be adopted as some form of palliative for investor emotions. Promulgating a rule that would not have any impact on the execution of abusive short sales may, in fact, foster further deterioration of investor confidence. Investors, ultimately, will only become confident again when trading rules are clearly being enforced and markets rise again. Rising markets will happen in the natural course of events, and will be encouraged by enforcement of effective anti-fraud and anti-manipulation regulations.

The STA is a strong proponent of the notice and comment process prescribed by the Administrative Procedures Act, which calls for participant examination of new regulations. We are, and have long been, proponents of a rulemaking environment where interested parties have the opportunity to air their opinions on issues that are considered by regulators before final rules are adopted. This debate affords many different perspectives to be heard and often identifies potential unintended consequences of proposed regulation. However, we would agree with other commenters who suggest that many of the comment letters being received on the topic of short sales have been manufactured by using "the powerful influence of the electronic mass media" and not some mass immersion of investors in the nuances of market microstructure. We expect the Commission to exercise "informed" judgment in analysis of these comment letters.

5Q. In addition to investor confidence and market volatility, we have stated that we are concerned about potentially abusive short selling. Would the proposed modified uptick rule or proposed uptick rule help address potentially abusive short selling? If so, how? If not, why not? Please explain and provide empirical data in support of any arguments and/or analyses.

A. Changing the mechanics of how a trade is executed will be easily circumvented. Rule 204T placed potentially costly restrictions on fails to deliver and has been very successful in attacking abusive naked short selling. Economic sanctions like 204T change the risk/reward profile of an abusive trade. Making abusive and manipulative short sale trades unprofitable takes the profit motive out of these trades and ends, or at least reduces this type of behavior.

6Q. We note that short selling provides the market with important benefits, including market liquidity and pricing efficiency. What effect, if any, would the proposed modified uptick rule or proposed uptick rule have on market liquidity? Please explain and provide empirical data in support of any arguments and/or analyses. What effect, if any, would the proposed modified uptick rule or proposed uptick rule have on pricing efficiency? Please provide empirical data in support of any arguments and/or analyses.

A. Restricting short sellers will certainly have a negative impact on market liquidity. Many short sales are hedged with a purchase of a similar security. If there is uncertainty concerning the ability of the trader to execute the short leg of the trade, the entire strategy is likely to be abandoned. Not only is the liquidity from the short sale lost but the liquidity provided by the planned purchase is also lost.

Price restrictions on short selling could distort the price discovery process. Forcing short sellers to post their stock on the offering side of the market instead of executing a trade by selling to the bid would allow a stock to trade at artificially high prices. Investors entering positions would have to pay more than would normally be necessary in a robust price discovery environment.

On the other hand, sell orders that are forced to offer could cause the display of large blocks of stock on the offering side indicating selling pressure, which may prompt long sellers to sell their positions more aggressively than they would otherwise. This would cause the issue to trade at prices below what should represent the equilibrium of supply and demand. In this case, buyers would reap a subsidy and sellers would receive less than what their assets are actually worth.

7Q. We also note that short selling may be used to illegally manipulate stock prices. What impact, if any, would the proposed modified uptick rule or proposed uptick rule have on “bear raids?” Please explain and provide empirical data in support of any arguments and/or analyses. To what extent, if any, does unrestricted short selling exacerbate a declining market? Please explain and provide empirical data in support of any arguments and/or analyses.

A. Most large short positions are entered into by using derivatives. The “bear raids” that have recently come to light have many characteristics in common. A collateral default swap position is purchased. Next, deep out-of-the-money puts are purchased. It is believed that the manipulator then begins to sell short. Long sellers notice the CDS spreads rising, large volumes of puts begin to trade and the downward spiral is exacerbated. Short sellers then cover at lower and profitable prices.

The Commission needs to develop new methods of identifying market manipulation. Cases need to be made quicker and violators should be prosecuted to the fullest extent of the law. A good deal of the frustration felt by market participants stems from perpetrators receiving insignificant penalties for violations of securities laws.

10Q. Should the proposed modified uptick rule or proposed uptick rule be limited to specific sectors or industries, such as financials, due to the unique harms or susceptibility to harms to those industries or sectors from the potential adverse effect of short selling in a declining market? If so, please describe the types of industries or sectors that should be covered and the unique harms or susceptibility to harm to which they are subject. Please also describe the mechanisms or criteria that should be used to determine which entities fall within these industries or sectors.

A. Sector restrictions are unnecessary and serve to degrade our markets. In the extreme, there remains the option of "trading halts." Restrictions on short selling in only the issues of financial services providers is perhaps the least valuable of all the ideas to be discussed during the short sale debate. Financial companies facilitate short selling in the markets by providing services directed toward short sellers. If a financial service company believes short sellers have been involved in some unscrupulous activities, they could simply stop enabling them.

Short selling in the financials may have been based on nothing more than accurate analysis of the fundamental weaknesses of these companies at that time. Perhaps the reason many short sellers held short positions in the financial sector was because they were customers of these companies and could clearly see the mismanagement and poor risk management. Many analysts saw the deteriorating balance sheets and a developing unhealthy economic cycle that played a role in the problems of the investment banks. There may have been abusive short selling in the financials, but it is also true that many short sales of these stocks were the result of accurately estimating their overvaluation.

11Q. One of the reasons for the elimination of former Rule 10a-1 and the prohibition on any SRO from having a short sale price test in July 2007 was because the application of short sale price tests had become disjointed with different price tests applying to the same securities trading in different markets. Under both proposed rules, all covered securities, wherever traded, would be subject to one short sale price test. What are the advantages or disadvantages of having a uniform short sale price test in the covered securities across all markets? Please explain.

A. If the SEC does decide to adopt a short selling regulation it must be on a market-wide basis. In the STA's August 2003 "Special White Paper: Fulfilling the Promise of the National Market System--STA's Perspective on U.S. Market Structure" we pointed out:

The existence of this "regulatory arbitrage" harms the integrity of the entire marketplace, impedes best execution, and does not serve to protect investors. As described below, the STA believes that consistent trading rules and integrated surveillance systems would further investor protection, improve execution quality, prevent fraud and manipulation, and reinforce principles of fair trade between members and their customers…. STA believes the SEC must mandate the adoption of consistent, standardized trading rules, such as the short sale rule, among markets trading like classes of securities (i.e. NASDAQ securities and exchange listed securities)….

Regulatory arbitrage had become a major factor in the determination of where trades were executed. Regulation SHO corrected this situation and it would be unacceptable to allow this problem to resurface.

12Q. How would trading systems and strategies used in today's marketplace be impacted by the proposed modified uptick rule or proposed uptick rule? How might market participants alter their trading systems and strategies in response to either proposed rule, if adopted?

A. Any rule which requires sequencing of bid or tick data will require a great deal of programming to accomplish. Storage of this data once it is collected will be very expensive because of the sheer amount that would need to be saved.

Algorithmic system providers would probably develop “sniffer programs” that would ferret out where offerings were building up, because of short sale restrictions or otherwise, and avoid taking the offers in such cases. This type of program would hasten the collapse of buy interest and could potentially increase the velocity of declines.

12Q (2). To further the goal of having a uniform short sale price test, both the proposed modified uptick rule and proposed uptick rule would provide that no SRO shall have any rule that is not in conformity with or conflicts with either proposed rule. Is this prohibition necessary or appropriate? Would there ever be a need for an SRO to institute its own short sale price test? If so, why?

A. This prohibition is absolutely appropriate and necessary. As we explained above regulatory arbitrage could become prevalent if venues are allowed to determine what their short sale restrictions should be. Some market participants would shift trading strategies to take advantage of less restrictive regulations. Other venues would notice the shift in trading practices and ease their restrictions in an effort to claim more market share ad infinitum. This would produce a regulatory race to the bottom.

If any short sale regulations were to be implemented there must be a minimum requirement to which every venue must adhere. We cannot envision any venue wanting to make the short sale regulations more stringent than the market-wide restrictions because of competitive reasons. However, if a venue were to propose stricter restrictions in an effort to attract listings or some other venue specific reason we would suggest that a thorough vetting of how that venue planned to interact with its competitors would be in order.

13Q. One of the reasons for the elimination of former Rule 10a-1 was that the disjointed application of the rule resulted in an un-level playing field among market participants. Could implementation of a short sale price test through a policies and procedures approach applicable to a “trading center” lead to disproportionate burden among market participants? In what way?

A. Regulatory arbitrage can also occur when a venue becomes less stringent in its enforcement efforts. While a policies and procedures approach to implementation seems to be widely desired in the industry, there must be a good deal of oversight to ensure that the policies and procedures are being evenly enforced across venues. Even the suggestion of supervisory laxity on the part of a venue would be enough to cause those looking for a more lenient environment to shift trading patterns.

13Q (2). Would a straight prohibition implementation approach be preferable in this regard?

A. While the prohibition approach would provide bright lines as to acceptable trades, it would complicate compliance and enforcement. With so many venues trading the same issue multiple times every second, strict adherence to a proscriptive price test rule would yield an inordinate number of cancellations further complicating the question of what the last sale or best bid really is. Indeed, as prints are cancelled for failure to adhere to these rules buyers would be put at risk of inferior executions. The prohibitions approach makes these rules incrementally less workable.

13Q (3). To what extent could the proposed exceptions to either alternative rule contribute to a disproportionate burden on certain market participants?

A. In general, exceptions dilute the effectiveness of a regulation by complicating compliance and enforcement. Multiple exceptions and exemptions not only lessen the regulatory burden on the chosen few, they encourage non-compliance in others. Rather than the voluntary compliance of all, the situation becomes "why should I comply if they don't?"

13Q (4). What effect might there be on relative competitive advantages of different market participants if the short sale price test were based on an increment larger than a penny?

A. Price tests of greater than the minimum price variation quickly approach a short sale ban especially for active stocks. If the short sale price restriction is moved to two cents above the bid, execution of the short sale becomes a highly unlikely event. Many active issues trade in penny-wide markets. Requiring a two-cent increment above the best bid for execution effectively shelves this strategy. Moving the restrictive increment any further would make the restriction a de facto short sale halt, removing any benefits short selling provides from the markets.

14Q. What impact, if any, would the trading requirements of Regulation NMS have on implementing the proposed modified uptick rule or proposed uptick rule?

A. Price restrictions on short selling could cause a greater incidence of locked markets. As buyers attempt to take an offering and bid that price for the security, the offer side at the away market may refresh. As offers build, some traders will opt to show only a portion of their real trading intent. As the displayed portion is taken, the venue where it was displayed will automatically refresh the quote showing an additional portion of an already resting order. Both the buyer and the seller will want to remain displayed because the displayed liquidity is considered to be adding liquidity and thus entitled to rebates from the trading venues. This could become a sticky problem because of the number of business models that profit from the liquidity provider rebates.

15Q. To what extent does the ability to obtain a short position through the use of derivative products such as options, futures, contracts for difference, warrants, credit default swaps or other swaps (so-called "synthetic short sales") or other instruments (such as inverse leveraged exchange traded funds) undermine the goals of short sale price test restrictions, such as the proposed modified uptick rule and the proposed uptick rule?

A. Most large short positions are currently entered through alternative vehicles as described above. Any move to restrict short selling must also regulate short equivalent vehicles. Should the Commission attempt to restrict short selling in only the cash equities market, we will undoubtedly see participants shift their trading to the derivatives market. Driving large volumes to short equivalent strategies could complicate the ability of derivative traders to hedge their positions. Derivatives traders will find alternative ways to hedge their positions if they are restricted in our cash markets, most probably offshore venues, and we will see a disconnect of the cash and derivatives prices.

The real loser in this would be the retail investor who uses short positions to hedge his portfolio. Retail investors in general do not have access to the strategies that many of the large participants who sell short do.

15Q (2). Will synthetic short sales increase if the Commission adopts either alternative short sale price test? What effects might such an increase have on market liquidity and pricing efficiency? Please explain.

A. The alternative short sale tests would curtail the ability of those utilizing the equity markets to hedge their overall positions in a financial strategy. They would be forced to find alternative solutions and the most logical would be the utilization of synthetic strategies to limit exposure. As this dynamic occurs, both the equity pricing and derivatives market's pricing mechanism would be directly impacted.

16Q. Before determining whether to adopt a short sale price test restriction on a permanent basis, should we adopt a rule that would apply, on a pilot basis, the operation of a short sale price test restriction for specified securities? Such an approach would allow us to study the effects on, among other things, market volatility, price efficiency, and liquidity during the recent changes in market conditions. What would be other benefits of taking this approach?

A. If the SEC insists on implementing a price test regulation it should definitely be implemented as a pilot program similar to the pilot used when price restrictions were removed. The STA has long been a proponent of incremental implementation. Unintended consequences can be identified while they only have an affect on a limited population of issues. The rule can then be tuned so the entire market does not have to endure the effects of the identified unintended consequence. It should be noted that any pilot program would force the industry to implement strategies to comply with its requirements. This would be costly and impact the broker-dealer community. As we expect this pilot will only serve to recertify the results of the previous Reg SHO pilot and the subsequent academic studies and analysis. We strongly disagree with this strategy, but require it if the Commission feels that a price test is the appropriate solution.

16Q (2). What would be the costs of taking this approach? Would the costs associated with programming systems to apply a short sale price test restriction on specified securities outweigh any benefits of having a pilot? If we were to take this approach, how long would it take to program systems to apply a short sale price test restriction to specified securities?

A. The costs of development, computer programming and policies and procedures development will remain the same as a permanent rule and the time to accomplish those tasks will not change either. Costs due to wider spreads and less liquidity will be confined through pilot implementation to a limited universe of securities. A pilot program could limit any further deterioration of investor confidence by providing investors evidence that the rules are ineffective and cannot stem the natural tide of supply (and demand).

16Q (3). Similar to the pilot conducted immediately prior to the elimination of former Rule 10a-1, the securities that could be subject to the pilot could be comprised of a subset of the Russell 3000 index, or such other securities as necessary or appropriate in the public interest and consistent with the protection of investors after giving due consideration to the security's liquidity, volatility, market depth and trading market. Would it be appropriate for such a pilot to be comprised of a subset of the Russell 3000 index? How should the securities that would comprise a pilot be selected? Please explain the reasons for any suggested selection method.

A. The selection process should be random to ensure the integrity of the data produced by the pilot. Critics with their own agendas have, we believe, acted in less than good faith in the past in their attempts to refute previous pilot data. This pilot must be developed to withstand these and future critics.

16Q (4). Such a pilot could remain in effect for one or two years. Would a one or two year pilot be an appropriate period of time? If so, why? If not, why not? Please provide specific reasons to support any views in favor of establishing another time period. Please provide any additional details regarding how a pilot could be structured in terms of the securities to be selected, the time-frame of the pilot, and the types of restrictions that could be placed on short selling of such securities.

A. We would support a two-year pilot with an interim evaluation schedule. In most statistical studies, more data equates to a higher degree of confidence in the study. However, since the pilot will be conducted in real time, we must be prepared to halt the pilot if severe unintended consequences appear. STA would support a two-year pilot with a semi-annual evaluation process where SEC data and independent studies could be used to appraise the effectiveness of the pilot.

17Q. In connection with the pilot conducted immediately prior to our elimination of former Rule 10a-1, SROs publicly released transactional short selling data so that data would be available to the public to encourage independent researchers to study the pilot. If we were to adopt a rule that would apply, on a pilot basis, a short sale price test restriction on specified securities, we would expect to make information obtained during any such pilot publicly available. In addition, we would expect SROs to again make data available to the public during any such pilot. Would there be any costs associated with making short selling data available to the public during the period of a pilot? What would be the benefits of making such data available to the public?

A. Since the data would be collected anyway, the costs to distribute that data should be negligible. Great benefits would come from independent entities studying the data. While the SEC OEIC performs admirably, its study results need to be confirmed by independent sources, especially in this regulatory environment. Independent organizations and academia could look at all the data from different angles and points of view and either confirm or refute the report of the SEC.

18Q. Commenters have stated that the pilot conducted prior to the elimination of former Rule 10a-1 was insufficient, in part, because it only covered a period of relative market stability and that the pilot should have lasted longer to “ensure at least one bear market was involved in the study.” Did the pilot cover a sufficient period of time?

A. The previous pilot actually went longer than was planned. While we have heard the argument that the study was conducted during a market with an upward bias and moderate volatility, and therefore the results are questionable because it was not studied during a bear market, the facts are that several academic studies back-tested the results to the bear markets of 1963, 1975, 1987, 1993 and 2000. The results of this back-testing were consistent with their findings. Yes, the pilot covered an appropriate amount of time and the study results are valid.

19Q. The proposed implementation period for both of the proposed rules would be three months from the effective date of the proposed rule, if adopted. Would a three-month implementation period be appropriate for the proposed modified uptick rule? Would a three month implementation period be appropriate for the proposed uptick rule? Should there be a shorter or longer implementation period for either proposed rule? Please explain.

A. Programming for data sequencing is a major departure from current industry practices. Most of the estimates that we have heard range from 8 to 12 months. Three months should be sufficient for a circuit breaker rule that would not require data sequencing, such as the STA circuit breaker pre-borrow proposal.

Questions Regarding Proposed Modified Uptick Rule

1Q. The proposed modified uptick rule would define the term "down-bid price" to mean a price that is less than the current national best bid or, if the last differently priced national best bid was greater than the current national best bid, a price that is less than or equal to the current national best bid. Should this definition be altered? If the last differently priced national best bid was greater than the current national best bid, should short selling be restricted to a cent above the current national best bid, or a higher or lower increment? If so, why? If a specific increment is suggested, please describe what impact such increment would have on short selling. What increment, if any, would be tantamount to a ban on short selling? Please provide empirical data in support of any arguments and/or analyses.

A. The Security Traders Association does not believe that the modified uptick rule will be effective in a penny-wide, electronic, decentralized marketplace. The appropriate area for the SEC to concentrate short sale restrictions on is the clearing and settlement side of the equation. The success of Rule 204T is a case in point. Just the threat of broker/dealers having to pre-borrow was enough to clear up the majority of fails to deliver. Changing market mechanics will lower market quality without altering volatility or reining in abusive short selling and it is probable that investor confidence will be degraded.

Questions Regarding Circuit Breakers Generally

1Q (1). The Commission believes that the erosion of investor confidence and questions concerning the volatility in the securities markets necessitate review of various alternatives with respect to short selling restrictions. Would a short selling circuit breaker be more appropriate than a market-wide short sale price test restriction in current market conditions? If so, why? If not, why not?

A. Single stock short sale circuit breaker rules would certainly let the majority of issues trade without the regulatory burden of short sale restrictions. We noted earlier that market-wide circuit breakers differ markedly from the single stock variety and may also have very different effects. We must be prepared to reverse course quickly if unintended consequences are identified.

1Q (2). Would a short selling circuit breaker provide more potential benefit to the market than a market-wide short sale price test restriction? Please explain. For example, would a short selling circuit breaker be a more appropriate means for the Commission to achieve the objective of helping to prevent short selling from being used as a tool to drive down the market? Please explain. Would a short selling circuit breaker rule help to address the Commission's concerns regarding investor confidence? If so, why and how? If not, why not?

A. No, the STA does not believe either solution will benefit the market. Price tests will not effectively deal with either investor confidence deficits or abusive short selling. Markets are too fast and too decentralized to be able to establish a benchmark price off, which would mark the appropriate short selling level on a fair and consistent basis. A short selling circuit breaker may initially provide a boost to investor confidence as a regulatory step toward thwarting a deteriorating stock price. However, as stated earlier this will, with experience, only serve to denigrate investor confidence as the rule proves to be ineffective in stopping the laws of supply and demand and accurate market pricing of a security based on the fundamental data available to the market participants.

2Q. Would implementation of a circuit breaker be less or more costly than the implementation of a market-wide short sale price test restriction? The proposed circuit breaker rules would, when triggered, impose short selling restrictions for the trading day on which the circuit breaker is triggered. Should the circuit breaker rules instead impose short sale price tests for multiple days? How many days? Would there be any additional costs associated with a circuit breaker that persisted for multiple trading days? Would a circuit breaker that when triggered imposed a temporary halt on short selling be more or less costly than one that resulted in a short sale price test restriction? Please explain. Would a short selling circuit breaker be generally easier to implement in a Regulation NMS environment than a market-wide short sale price test restriction such as the proposed modified uptick rule, or the proposed uptick rule.

A. The development and implementation costs of a permanent market-wide price test and a circuit breaker price test would be significant and similar. The circuit breaker proposals would keep the ongoing costs of wider spreads and lower liquidity to a minimum. The length of time in which the circuit breaker restrictions are in effect would have nominal incremental costs to implement. The enhanced surveillance costs would become a fixed cost with the implementation of either strategy.

<u>Marking</u>

Request for Comment: We seek comment generally on all aspects of the proposed amendment to Rule 200(g) of Regulation SHO. In addition, we seek comment on the following:

1Q. What type of costs, if any, would be associated with requiring sell orders to be marked “short exempt” when relying on an exception under proposed Rule 201? What types of costs, if any, would be associated with not requiring sell orders to be marked “short exempt” when relying on an exception under proposed Rule 201?

A. The SEC needs to get a handle on the extent of short selling and the extent that exceptions and exemptions are being used to circumvent the regulations. The costs of marking the orders appropriately will be worth the benefits gained. As this discussion progresses, exact data will allow the facts to prevail over any perceptions.

2Q. Should the proposed rule require a broker-dealer marking a sell order “short exempt” to identify the specific provision on which the broker-dealer is relying in marking the order “short exempt”? If not, why not?

A. Absolutely, again this data will prove very valuable during future discussions of this topic. Being able to dispute unsubstantiated finger pointing will allay investor fears and boost investor confidence.

3Q. What would be a sufficient implementation period for making any systems changes necessary to allow sell orders to be marked “short exempt”?

A. Order marking will require new fields in the order coding, which should be accomplished in approximately three months.

4Q. Please describe any anticipated difficulties in complying with a “short exempt” marking requirement.

A. The STA does not see any potential problems in complying with this requirement.

5Q. The “short exempt” marking has historically been used only for short sales that are excepted from a short sale price test. For instance, the “short exempt” marking was not available for short sales that were excepted from the Regulation SHO locate requirement of Rule 203(b). We are, however, proposing to require short sales that are excepted from the proposed circuit breaker halt rule, when triggered, to be marked “short exempt.” Would a “short exempt” marking be needed for the proposed circuit break rules if circuit breakers operate in place of short sale price test restrictions?

A. Absolutely, the Commission needs to know who is making short sales, who is complying with these rules, and who may be using exemptions and exceptions to avoid compliance.

Exemptive Procedures

The proposed alternative short sale price test rules and the alternative circuit breaker rules would establish procedures for the Commission, upon written request or its own motion, to grant an exemption from the rules' provisions, either unconditionally or on specified terms and conditions, if the Commission determines that such exemption is necessary or appropriate in the public interest and is consistent with the protection of investors. Pursuant to this provision, we would consider and act upon appropriate requests for relief from the proposed short sale tests’ provisions and the proposed short sale circuit breakers’ provisions, if adopted, and would consider the particular facts and circumstances relevant to each such request and any appropriate conditions to be imposed as part of the exemption. We solicit comment regarding including a provision for exemptive procedures in the proposed short sale price test rules and the proposed circuit break rules.

A. While we think that it is important for the Commission to have detailed procedures for granting exemptions, we also believe that such exemptions lessen compliance with the rule. As one competitor sees another granted an exemption, he will attempt to tailor his circumstance to also avoid regulation. The more exceptions and exemptions that a rule has diminishes compliance by all participants. That said, we believe that the Commission must set the bar high for those seeking exemptive relief.

Again we appreciate the opportunity to help the Commission in the quest to bolster investor confidence and stem abusive short selling and manipulation.

Sincerely,

Peter J. Driscoll
Chairman

John C. Giesea
President & CEO

cc: The Hon. Luis A. Aguilar
The Hon. Kathleen L. Casey
The Hon. Troy A. Paredes
The Hon. Elisse B. Walter
James Brigagliano, 2nd Deputy Director Division of Trading and Markets
Daniel Gallagher, Co-Acting Director, Division of Trading and Markets