To: U.S. Securities and Exchange Commission

Subject: S7-08-09 Proposed Amendments to SHO

Date: 19 June 2009

The Commission in this voluminous 273-page proposal lays out alternative solutions restricting short sales at the bid in a down market. It is this very narrow issue that is in question, not short selling in general -- yet the two are intertwined by those who argue the benefits short selling has on market liquidity, concluding that this is not a real issue but simply a problem with perception. Based on the Commission and staff comments in public forums to date, it is also unclear whether the SEC itself feels the issue is real or one of perception. In addition, there is a whole area of derivative investment vehicles that have the capability of causing the collapse of a stock that is equal to if not greater than the issue addressed by this proposed amendment to Reg SHO. I would urge the Commission to address those concurrently with this rule proposal. It is an equally serious problem but these proposals do not address derivatives and I have confined my remarks as well to the specific alternatives put out for comment.

This complicated approach of multiple solutions appears to take into account the interests of all the parties affected. However, since the present market structure will prevent us from going back to the old uptick rule(or its counterparty the bid test), we are left with one of the circuit breaker alternatives as a compromise. The circuit breaker concept largely keeps unrestricted short selling as the status quo. It will accommodate the exchanges and various niche interests of market participants while at the same time, satisfying the public and Congressional desire to "do something". Regardless of the choice, such compromise will be virtually useless in solving the problem encountered with a steep market decline. This is no time for the SEC to take partial steps. Congress, and more importantly, the investing public and the investment institutions through which they participate are looking for the protection only the Commission can provide. Their confidence will not be restored by preserving or protecting unrestricted trading for the special niches e.g. investment funds enabling buyers to profit twice the amount of a decline of an index or in hedging, arbitrage, credit default swaps and other esoteric financially engineered products. All the so-called "low risk" trading strategies that have been the root cause of virtually every financial debacle in the last 30 years. Arguing that selling short on a down bid is a vital component of making the US markets the best in the world, falls on deaf ears when one has just lost their retirement. Make no mistake - the public's confidence in the equity markets has been badly damaged. <u>There is a solution however rooted in one of the Commission's alternative proposals. With only a minor variation, it faithfully replicates the old uptick rule. It can be done with no technology changes, no cost to the exchanges and with order entrants utilizing an existing order type for short sales. If the legal time period for adopting a rule was met, it could be implemented tomorrow. This proposal is discussed on page 3.</u> The remaining parts of my comments are directed to other aspects of each alternative proposal that disadvantage the investing public.

The first proposal is a price test imposed on the entire universe of listed issues, permanently in place and operating during the time the market is open. The price test would be based on either the last sale or the current bid. **Comment:** Because of the multiple points of entry, execution and the delay in reporting the last sale, it is clear that it is impossible to return to the old uptick rule without changing the existing market structure. Participants at the May roundtable discussions seemed to draw that same conclusion. That same bias is reflected in the SEC's own rule proposal and therefore I assume that issue is off the table as a viable choice.

Using the current bid as a price test is only a modest improvement over the use of the last sale. While bids are more indicative of the current market, and the bid test did work for nearly a decade in the Nasdaq market, Nasdaq was the collector and disseminator of quotes as well as the operator of the automated execution system. The flickering quote, a product of potentially thousands of messages flooding the quote in any given stock, marks a significant difference between that time when Nasdaq controlled the quotation system and today. Using this flickering bid, as a price test does not suffer from quite the same sequencing problem of using last sale data, but a bid can potentially change across different market centers from up to down hundreds of time in a second. With each of the market centers capable of receiving and handling close to 100,000 messages per second it is not hard to envision, market participants, armed with computer programs routing bids in a set sequence, along with instant cancellations, producing a desired sequence of bid changes. Quote changes that would enable them to effect a short sale against a legitimate bid that initially was a down bid (and therefore not eligible to be hit), and now through this mechanism be an up bid and eligible for an execution -all within the space of a second. Therefore, using the current bid as a test price would require a significant change in the exchanges' and market participants' technology to produce the controlled scenario employed by Nasdaq and the old bid test. Anything less than a carefully controlled collection and sequencing of bids would prove meaningless.

Returning to the past is not a feasible path with either alternative. Unfortunately, the investing public and Congress will not understand nor care about the nuances that multiple market centers, latency of trade reports and computer driven quotes have on adopting a modern day version of 10(a)1, so the Commission will be left with choosing an alternative that accomplishes the same goal.

The second proposal was security specific and used a circuit breaker concept. A decline in the stock would trigger either (1) a complete halt of short selling or (2) a temporary imposition of a short sale price test based on the last sale or (3) the temporary restriction of short sales through a so called "modified uptick rule" based on the current bid. Lastly, there was a request for comment on a proposal requiring participants to mark their orders "short exempt" when relying on an exemption to any short sale rule that might be adopted. **Comment:** As for the latter, when Nasdaq adopted its bid test, market makers were required to mark their execution reports "short exempt" when they were relying upon their market making exemption. To the degree that the

Commission sees fit to provide any exemptions, it is logical that participants exercising that exemption be required to identify the exemption for ease of surveillance.

As for the various Circuit Breaker Rules, based on the prior discussion, I believe (2) above can be eliminated as a solution for all the previously cited reasons regarding "last sale" as a price test. Use of (3) above, the so-called modified uptick rule in conjunction with a circuit breaker appears to be a similar version of a proposal a group of exchanges submitted to the Commission prior to its April public hearing. There was one notable difference. The modified uptick rule was not dependent on the bid being down for the restriction to apply. By introducing this condition, the proposal brings back the problems associated with a flickering bid. I would urge the Commission to adopt the"modified uptick rule" as a stand-alone proposition i.e. without the circuit breaker and without being encumbered by a bid test. To be clear, I would propose that short sales be required to be entered as passive limit orders above the market. With this approach, the short sale order, upon execution creates its own uptick. It solves the logistical problems associated with multiple points of execution and flickering quotes. It reduces a large portion of technology expense associated with gearing up systems to constantly track bid changes and determining if orders are eligible for an execution as short sales. It is actually superior to 10(a) 1 in that it accomplishes one other very important thing – every short sale is turned into a positive liquidity force in the market. Even with the old uptick rule, short sellers were rarely making a trade that added to liquidity. It also would have the effect of potentially narrowing the spread to the lowest possible increment. If the Commission determines the burden to enforce should fall to the exchanges i.e. reject or modify the limit order to sell short, along with monitoring the bid quote for it being up or down, the technology effort to implement would be significant. If you eliminate the additional step of requiring the exchange to determine if a short sale is legitimately executable and require the order entrant to modify the short sale with a "post only" condition, the technology effort is nil. Specifically, the order comes into the market center and if immediately executable, the exchange simply rejects the order as it does today with any "post only" order. If, and when the short sale is posted as a limit order, it goes into the queue as a regular limit order, with a normal price and time priority. When it is executed, it is because buyers have lifted the offering and not because the short sale has hit the bid. As a point of fact, the intent of the seller would not matter because it would not have the capability of producing the intended effect. With no technology barriers to put in place, the rule could be adopted tomorrow.

In addition, by introducing the concept of a "circuit breaker" there is the basic assumption that allowing unrestricted short selling in "normal" times adds to liquidity and promotes price discovery, with the modified uptick rule acting only as a backstop when the trigger point of the circuit breaker is breeched. However, the use of a circuit breaker renders their proposed modified uptick rule virtually useless in controlling the kind of unrelenting pressure coming from short selling that we witnessed in the fall of 2008. Had this proposed combination been in place during that period, it would have just taken perhaps a few more days to get stock prices to the levels that we saw. The only positive aspect of this circuit breaker is that it will prevent short selling from driving the price of a stock to zero in the space of one day. Enumerated below are the reasons for the Commission to reject the circuit breaker concept.

1. Liquidity – During the Commission's public hearing as well as in the round table discussion groups, the call for providing empirical data to bolster the need for a rule change

was heard repeatedly. Logic sometimes trumps empirical data and here are a couple of examples. First, the roundtable participants brought up the prohibition of short selling in financial stocks in the fall of 2008 as evidence that there was no liquidity, extreme volatility and wide quotes. This was somehow evidence that restricting short selling hurt trading in these securities. What investor in their right mind would step in and be willing and buy or sell companies that many in America thought were on the edge of bankruptcy. The marquee names of Lehman and Bear Stearns were gone and Wachovia was selling at a dollar and not thought to be worth that. Also, there was a total prohibition on short selling. That time period produce empirical data but that data is hardly relevant. For those market participants who think nothing should be done, the SEC's own study was often cited as empirical data that supports their argument. As exhaustive as that study was, it did not take into account a yearlong erosion of prices culminating with a steep drop at the end, the bursting of the housing bubble and the whole financial industry and securities markets in total disarray. The study was done and much empirical data collected. It most likely reflected what impact unrestricted short selling had on stocks during that period. However, no one ask the question what would happen in a bear market. For this failure, the Commission must take the responsibility. The exercise we are going through now is one of the unintended consequences of removing the restrictions based on an exhaustive amount of empirical data. Unfortunately, the data was not relevant to all situations. Another example to consider is a simple, single transaction of a short sale of 1,000 shares hitting a bid(s) and for the moment assume it is a down bid. That sale will never add liquidity. In fact, that short sale is taking liquidity away from any potential long seller. Now, multiply that transaction by hundreds of thousands times a day and you cannot bootstrap your way into a liquidity-providing scenario. No study or other empirical data can do it either because it is simply not logical for a multiplier effect to turn the scenario around. There is never a time when hitting ever-lower bids adds to liquidity - not down 10%, 5% or any percentage below the bid. If hitting bids added liquidity, the exchanges would have to turn their present rebate schemes upside down. Exchanges understand that providing liquidity is important and are willing to pay for it. They currently pay those who post a bid or offer because those orders are the only ones deemed to add liquidity. They charge the short sellers hitting bids because they are taking liquidity out of the market. It is not logical to think the exchanges can argue that short sales add crucial liquidity but not be willing to pay for it. They cannot have it both ways. However, the modified uptick rule without the circuit breaker would turn every short sale into the category of being a liquidity provider. One last point about empirical data and studies in general-it is very hard to isolate the reason(s). Remove or change one element of the equation and the other parts fold in around filling the void. Strategies change. People adapt to accomplish their goal. For example, when the SEC mandated decimals, ostensibly to save investors money, in fact drove traditional old style market makers out of the business. That change however created a void and gave rise to entities with huge dollar pools of money using low risk, high volume, computer driven trading strategies to extract pennies out of every trade. With short sale trading restrictions removed and only a penny or two at risk, trading on the downside became a piece of cake. This is just an example of why the Commission should not worry that preventing short sales at the bid will cause some sort of upheaval of the securities markets. People will adapt, strategies will change and the markets will go on.

2. Spreads- In the same vein as liquidity, spreads are also predicted to widen if short sellers are restricted from hitting bids. Take our simple transaction from above of selling short 1,000 shares and for this example assume the market is a 20 Bid for 500 shares Offered @20.05, or a spread of 5 cents. There is no way that selling short 1,000 shares at the bid is going to do anything other than widen the spread to 6 cents, even if only momentarily. Once again multiplying this short sale by any number of times you choose, the result is the same- a widening of the spread every time it occurs. It simply is not logical to arrive at a different conclusion. However, if you adopt your proposed modified uptick rule without the circuit breaker, and the short sale is entered into the market, it could do so as low as a 1,000-offered @20.01 and the spread collapses to 1 cent i.e. a reduction of 4 cents.
3. Price Discovery - It is generally conceded that short sellers do at times help dampen the unwarranted upside price rises by adding to the supply of available stock that long sellers are not willing to part with even at higher prices. In these instances, short selling serves a legitimate purpose. This is on the upside and the proposed modified uptick rule does not impede that at all. However, it is a specious argument that short sellers help price discovery on the downside. How is it that huge pools of capital, utilizing computers to track thousands of 3 and 4 letter symbols, and when matched with predetermined price movement formulas, fire off thousands of orders within seconds and billions of shares in the course of a day, help the price discovery process? This trading activity comes so fast that there are times when the cancellations arrive at a point of execution before the original order to sell short has arrived. Is this some new invisible hand helping the market arrive at the correct price level?
4. Trading Range -The proposal argues that in "normal" times, unrestricted short selling is purely benign and the modified uptick rule is unnecessary. For the sake of argument and using the 10% circuit breaker example, there would be a window of time and a price level each day, in which the short sellers could act with impunity until the price of the stock breeched its 10% down level. Would an investor feel better if their stock went down 50% in the space of couple of days rather than one day? Once a stock is put into play with a downward trend, will the trigger point be a self-full filling prophecy. Whether the so-called magnet effect is real or not, price declines beget more selling both long and short and buyers get out of the way or do not step in. The effect is still the same. Short selling may not be the cause but it will exacerbate the problem. Considered from an investor's perspective, what is the point of stretching out unrelenting pressure from short selling from one day to five days or longer? It may even make the problem worse. The idea might have some legitimacy, if a "normal" range of trading could be devised for each individual stock that would trigger the "circuit breaker" but that would introduce another whole level of complication far greater than the proposed circuit breaker. Even with the circuit breaker set a 10%, exchanges will have to utilize technology resources to track every stock all the time, calculate a unique circuit breaker for each stock and that is just to determine who is on the list and who is not- different from moment to moment throughout the trading day. If there was an inordinate amount of confusion over the outright prohibition of short selling in a list of 600 financial stocks this past fall, how would investors cope with all the stocks listed on the exchanges, each with a different circuit breaker? It is equally illogical and just as complicated to say all stocks have the same percentage of a normal trading range. 10% and even 5% is ridiculously high for all but a handful of securities. Therefore, what will the range be – somewhere between 1% and 3%? Whatever range picked, it will be arbitrary

and wrong for virtually all stocks because at some point in time trading ranges can and do change. It is also introducing a formula to the execution process that by definition will be an ever-changing absolute number for each stock. Without knowing the precise answer I suspect it will be a technological challenge to build; and will certainly slow down the execution process. As a last note on the trading range concept, a legitimate case could be made for unrestricted short selling for any stock that was up on the day from the previous day's closing price. In those instances short selling, even when hitting bids, does contribute to liquidity. If the circuit breaker was yesterday's closing price then the modified uptick rule could be used for all short selling at or below that price. It certainly would be a price mechanism easier to track and to comprehend by market participants.

5. Compliance - The circuit breaker concept will make compliance harder, not easier - exactly the opposite of what exchanges have asserted in the past. Determining whether a stock is subject to the modified uptick rule, with a moving trigger point, is what introduces unnecessary compliance issues – both for the exchanges who will be charged with enforcing the restrictions and for the firms managing their client and proprietary activity. In addition, if the system(s) fails, there could potentially be thousands of erroneous trades. These will all have to be adjudicated in some way and the market will not be standing still while the problem is sorted out. This is a compliance nightmare and as is often the case, purely innocent parties turn out to be the losers in that scenario. However, unfettered by the circuit breaker, the modified uptick rule is simple. If the exchanges are capable of rejecting a short sale order when it is not above the prevailing bid and the order has been marked properly, there is nothing left to be done. All rules should be so simple for compliance officers.

Not mentioned in any of the proposals are the basic concepts of fairness and transparency. These are areas, which the investing public looked to the SEC for its leadership. I believe the items listed below are worthy of your consideration. Specifically:

1. Fairness-When a long seller is attempting to sell at a given price and coincidentally is competing with a computer-generated short sale, the long seller will lose that price competition every time. All those pennies that the SEC was saving the investor when it went to decimals, the investor is losing that and more every time they compete with short sellers in getting to a bid. On the downside, every penny made by a short seller is nearly always at the expense of a long seller at any given price level -- after all, the shorts don't wait politely in line until all those who are long the stock go first.
2. Transparency – Most of those arguing against any restrictions, diminish the role short selling has on the market including the Commission's own study that led to the lifting of the restrictions. That begs the question - if there is so little of it going on why is it so important to preserve. This small percentage of activity is surely not the essential component in maintaining our status as the best market in the world. After all, we had the world's best market five years ago when we had the full-blown uptick rule and bid test. To clarify that issue, I would propose we find out exactly how much short selling actually exists by creating a real time short interest volume display or query. Reporting short interest every two weeks is meaningless. Even reporting short interest at the end of the day does not take into account the billions of shares shorted and covered during the day. Making short sales transparent to the

market would be a positive step for several reasons. First, it would clarify for the whole market whether selling is coming from the holders of the stock or from those making a bet that the price is going lower. Not only would this be of interest to the direct market participants but is of particular interest to the issuers, who constantly complain about short selling in their company stock. This real time display would eliminate that speculation forever. Equally important, real time short sale reporting will give the regulators a capability to help identify potential violations, such as short selling in front of bad news – as the damage and violations are occurring, not months and years after the fact. More generally, they will be able to monitor on a real time basis the significance short selling is having on a particular stock and the market overall and will be in a position to demonstrate short selling is not a destabilizing force in the market. It will also know precisely how little or how much of the daily volume is attributable to this activity and can better gauge any subsequent actions that it may wish to take. It certainly would have put the Commission in a position of knowing the true extent of short selling in the bank stocks before restricting short sales entirely in September 2008.

3. Settlement- I also propose that the Commission move to a T + 1 settlement date as an interim step toward same day settlement. We live in world of micro second trading and a 3-day settlement. That is inefficiency in the extreme. This change would remove additional systemic risk caused by participant failures as well as eliminate many issues that surround settlement on short sales, buy in requirements and the accompanying stock loan/borrowed machinations.

Finally, we have witnessed in one short year the loss of trillions of dollars by investors and a near collapse of the banking system. Short selling was not the cause of the melt down of our financial markets but it did play a role in fueling price declines and was a major cause of investors losing confidence in the market and in those charged with protecting their interests. It will continue to do so in the future unless the SEC eliminates short selling at the bid as an issue. Any rule proposal that incorporates the circuit breaker simply means the issue of short selling will not be put to rest because the circuit breaker will not eliminate the havoc short selling can have on the market even if it is over a period of days. If the public finds itself in the same position of facing steep declines in share prices similar to what they just went through and short sales are even perceived as contributing to the decline, they will once again be demanding the government to "do something"; and the next serious decline is coming sooner then you think. If Congress is faced with the same outrage from their constituents as they have just gone through, they will simply mandate their own solution, They may even do so this time around if they think the rules the Commission adopt do not go far enough. There is no downside to eliminating the problem once and for all. The Commission should not worry that preventing short sales at the bid will cause some sort of major upheaval of the securities markets. People will adapt, strategies will change and the markets will go on. Why compromise and take a half step when the potential risk is so great. In my opinion, failing to bring finality to this matter is neither in the best interest of the investing public nor the SEC itself.

Respectfully,

Glen Shipway

Public Investor

cc: Congressman Barney Frank, Chm – Financial Services Committee

Congressman Gary Ackerman, Financial Services Committee

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