

June 23, 2011

Via Electronic Filing

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

**Re: Short Sale Reporting Study Required by Dodd-Frank Act Section
417(a)(2), Rel. No. 34-64383; File No. 4-627**

Dear Ms. Murphy:

The Investment Adviser Association (IAA)¹ appreciates the opportunity to comment on the Commission's request for public comment on behalf of its Division of Risk, Strategy and Financial Innovation (Division) with respect to studies required by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). Specifically, section 417(a)(2) of the Dodd-Frank Act requires the Division to conduct studies of the feasibility, benefits, and costs of requiring short sale position reporting in real time and the prospect of conducting a voluntary pilot program in which public companies could agree to have sales of their shares marked and reported in real time.² Through the Study Release, the Division is seeking comment on both the existing uses of short selling in securities markets and the adequacy or inadequacy of currently available information regarding short sales as well as on the likely effect of possible future reporting regimes on the securities markets, including their feasibility, benefits and costs. In this letter, we provide comments only with respect to the short sale position reporting and do not provide comments on transaction reporting in which transaction marks would be added.

We support the Division's approach to assessing carefully the effect of short sales on the securities markets and the potential impact on short selling of imposing additional reporting requirements. We recognize that short selling was perceived by some as contributing to the rapid decrease in prices in certain stocks during the financial crisis of 2008

¹ The IAA is a not-for-profit association that represents the interests of investment adviser firms that are registered with the SEC. For more information, please visit our web site: www.investmentadviser.org.

² Short Sale Reporting Study Required by Dodd-Frank Act Section 417(a)(2), Release No. 34-64383 (May 3, 2011) (Study Release).

and the overall volatility in the securities markets. We, therefore, have supported efforts by the Commission and regulators around the world to ban abusive short selling that could lead to the destabilization of the financial markets.³

We submit, however, that short selling has many benefits, including hedging risk which is one of the primary reasons many of our members engage in short selling on behalf of their clients. Short sales may be hedges of holdings, cross-hedges or the byproducts of other strategies that seek only to isolate the specific risk being taken. Our members also may use short selling as a tool to implement a particular investment idea. Moreover, short selling is considered to improve market liquidity and aid price discovery.⁴ Short selling improves market liquidity by multiplying the number of sellers in the market; short selling can increase market efficiency by increasing trading volumes and reducing transaction costs by decreasing bid/offer spreads. Short selling also aids price discovery by allowing information to be fully reflected in the price of the security being sold short. Given the benefits of short selling, we urge the Commission to avoid disincentives to short selling by requiring disclosure only to regulators and only of information that is essential to prevent abusive practices and to exercise proper oversight of the securities markets.

Benefits of Short Position Reporting Do Not Outweigh the Costs

The Division requests comments on the benefits and costs of short position reporting by all investors, intermediaries, and market participants. The Commission has previously analyzed whether information about short sale positions from institutional managers should be required, and we respectfully submit that we are aware of no data or facts that would change the conclusion that the benefits do not outweigh the costs.

During the midst of the financial crisis in 2008, the Commission deemed it necessary to require reporting of information about short positions to monitor for manipulative short selling practices in light of the unprecedented fluctuation of securities prices, particularly affecting the financial services sector. At that time, the Commission adopted emergency orders and adopted an interim final temporary rule requiring certain institutional investment managers to file information on Form SH concerning their short sales and short positions. The Commission had made the rule temporary so that it could “evaluate whether the benefits

³ See e.g., Letter to Florence E. Harmon, Acting Secretary, U.S. Securities and Exchange Commission, from Jennifer S. Choi, IAA, dated December 11, 2008 (Amendments to Regulation SHO, Rel. No. 34-58773; File No. S7-30-08); Letter to Stephen Sie and Don Groves, Market Monitoring, UK Financial Services Authority, from Jennifer S. Choi, IAA, dated May 5, 2009; Letter to Mr. Carlo Comporti Secretary General, Committee of European Securities Regulators, from Jennifer S. Choi, IAA, dated Sept. 29, 2009.

⁴ See Technical Committee of the International Organization of Securities Commissions, Consultation Report on Regulation of Short Selling (March 2009); Short Sales, Release No. 34-48709 (Nov. 6, 2003); Merritt B. Fox et al., *Short Selling and the News: A Preliminary Report on an Empirical Study*, 54 N.Y.L. SCH. L. REV. 645, 646 (2009/10), available at http://www.nyls.edu/user_files/1/3/4/17/49/1000/Fox%20et%20al%2054.3.pdf; Paul Lynch, Senior Managing Director, State Street Securities Finance, Statement before the Securities and Exchange Commission, Securities Lending and Short Sale Roundtable, Panel 1: Controls on “Naked” Short Selling: Examination of Pre-Borrow and Hard Locate Requirements (Sept. 30, 2009), available at <http://sec.gov/comments/4-590/4590-33.pdf>.

from the data justified the costs associated with the rule.” In permitting the interim final temporary rule, Rule 10a-3T (and Form SH), to expire in 2009, the Commission presumably made the determination that the benefits did not, in fact, outweigh the costs. We applaud the Commission for not adopting permanently a requirement on investment managers that did not have quantifiable benefits to the markets or to the regulators.

Given that the Commission has just undertaken this analysis and determination recently, we believe the Division should not recommend any further position reporting by institutional managers. Moreover, section 929X of the Dodd-Frank Act requires the Commission to adopt rules providing for public disclosure of the aggregate amount of the number of short sales of each security on a periodic basis rather than requiring public disclosure of individualized short sale information by institutional managers.

If the Division, however, goes further than the requirements of the Dodd-Frank Act and decides that individual reporting of short sale position by institutional managers is necessary, we believe that the additional issues discussed below must be fully considered in developing any reporting regime.

Frequency of Filing

In the Study Release, the Division asks whether real time reporting would be beneficial. We strongly believe that real time reporting of short positions by institutional managers would place a significant burden on these managers without any quantifiable benefit. In fact, the burden imposed by real time reporting may deter institutional managers and others from non-abusive short selling and fully implementing their desired investment strategies.

Moreover, as an ongoing requirement, we are of the view that weekly filings as required by Form SH are too frequent. During the unusual and unique circumstances of the financial crisis, we appreciate that frequent reporting may have been necessary for the Commission to monitor possible manipulations of the markets. During normal market conditions, however, such a frequent filing requirement is not critical and is onerous for institutional investment managers. We believe it would be more reasonable to require a quarterly filing in connection with Schedule 13F.

Short Sale Positions Should Only be Reported to the Commission

The Division requests comment in the Study Release about the feasibility, benefits and costs of reporting only to the regulators. If the Division determines to recommend reporting of short sale positions, it should limit the requirement to reporting to the Commission and not require public disclosure. Reporting of short positions to the public will have detrimental effects for investment managers required to report, as well as their clients, and such reporting is not necessary for the proper functioning of the securities markets.

Public disclosure would substantially harm investment managers by potentially exposing their investment strategy to those who hope to misappropriate the intellectual

property of investment managers without having to pay for developing an investment strategy. Moreover, real time public reporting would further exacerbate this harm by permitting those trying to mimic the strategies of institutional managers with greater precision and frequency. The disclosure also could result in the “herding” effect where short sellers may follow influential market participants’ decision to sell short and thereby exacerbate a downward price spiral.

Ultimately, the reduced effectiveness or performance of the investment strategies used by reporting investment managers would be a cost that is borne by clients of those investment managers. Absent a clear benefit to the functioning of markets, we believe this would be an unfortunate and inappropriate result.

To the extent that enhanced transparency of short selling can provide insight into short sellers’ price movement expectations and can improve pricing efficiency and could help to detect short selling that is being used to commit market abuse, we believe these benefits can be obtained from a combination of market participant transactional disclosure to the Commission with public disclosure by the Commission of the aggregated positions for individual securities.

Appropriate Threshold for Reporting

The Division asks how the establishment of a significant reporting threshold would affect the costs and the utility of the short position information. We are of the view that, if the Division decides to recommend short sale position reporting, it should propose an appropriate threshold level for reporting to obtain meaningful information. Requiring the filing of small positions only detracts from more useful information that can be provided to the Commission. For example, institutional investment managers may be permitted to exclude short positions that have a fair market value of less than \$10,000,000 or constitute less than 2.5% of that class of the issuer’s outstanding securities.⁵ Particularly for small and even mid-cap securities, a lower percentage threshold can be reached easily and would capture relatively insignificant short positions.

Disaggregation Among Affiliates That Do Not Share Information about Investment Decisions

For purposes of reporting short sale positions, investment managers in a corporate group should not be required to aggregate the holdings of control affiliates to determine whether the affiliates or the holding company would be required to report. We believe that when investment managers are deemed to share investment discretion only because of control relationships and affiliates do not share information about investment decisions for business

⁵ In Form SH, the Commission permitted institutional investment managers to exclude short positions that have a fair market value of less than \$10 million and constitute less than .25% of that class of the issuer’s outstanding securities. At that time, the IAA expressed our concern that, for small and even mid-cap securities, the .25% threshold could be reached easily and would capture relatively insignificant short positions and that the \$10 million threshold was not as helpful in eliminating smaller positions. We requested that the Commission revise the exemption to either increase the percentage threshold (*e.g.*, 2.5%) or permit investment managers to exclude positions for reporting purposes if the positions satisfy either one of the two conditions.

purposes, short positions of affiliates should not be required to be aggregated to determine whether there is a reportable short position for the affiliate group for several reasons.

First, mandating affiliated investment managers to aggregate short positions would force these managers to share information about investment decisions for purposes of disclosing short positions that they otherwise would not share. Requiring sharing of information for these purposes is at odds with the information barriers and other policies and procedures that are typically in place to ensure that affiliates do not have access to any non-public information regarding other affiliates.

Second, requiring affiliates to report positions that individually would not be reportable or requiring the holding company to report the aggregated position would present at best an inaccurate, and at worst a misleading, picture to regulators and to the market. This type of reporting also may lead regulators or markets to view the short positions as being coordinated among affiliates in a group when that is clearly not the case. We believe aggregating in these situations – where investment decisions or information about investment decisions are not shared among affiliates – would send confusing and unhelpful information to regulators and to the market regarding short sales.

For these reasons, we believe investment managers with the same parent company should not have to aggregate short positions if they do not share information about investment decisions. Similarly, a subsidiary and a parent should not be required to aggregate holdings if they do not share information about investment decisions.

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The IAA appreciates that the Division is seeking input on its study on requiring reporting of short sale information. We believe that the Division should only recommend reporting requirements if the information will provide useful information to the Commission that outweigh the significant costs to market participants and their clients. Data during the financial crisis have already shown that this information is not of critical importance to the Commission or the securities markets. Moreover, the Commission already has made the determination that the benefits of the disclosure did not outweigh the costs when the interim final temporary rule was being evaluated for permanent adoption. We urge the Division not to recommend reporting now merely for the sake of reporting but only if the information to be gathered is critical to the regulatory program or to the proper functioning of markets. We appreciate the opportunity to provide our views on these issues and would be pleased to provide any additional information. Please contact the undersigned or Karen L. Barr, General Counsel, at (202) 293-4222 with any questions regarding these matters.

Respectfully submitted,

/s/ Jennifer S. Choi

Jennifer S. Choi
Associate General Counsel

cc: The Honorable Mary L. Schapiro, Chairman
The Honorable Kathleen L. Casey
The Honorable Elisse B. Walter
The Honorable Luis A. Aguilar
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