

June 23, 2011

BY EMAIL

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

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

Dear Ms. Murphy:

Thank you for the opportunity to comment on the SEC's release (No. 34-64383) concerning short sale reporting. Question 15 of the release asks, "How should experiences with short sale position reporting regimes in foreign jurisdictions inform the analysis of feasibility, benefits, and costs? How relevant are any analyses of other reporting regimes to the Division's study? The Commission requests information on any relevant studies not cited in this request for comment."

We are writing to provide you some preliminary results from our ongoing analysis of the recent UK experience with short position disclosure. Our research is in progress, and we have not yet completed a study detailing our work, but given the comment deadline and the importance of the SEC's proposals, we wanted to share our initial findings.

Executive Summary

In September 2008, the UK Financial Services Authority (FSA) banned short selling in UK financial stocks and instituted a short position disclosure regime. On January 16, 2009, the FSA lifted the short sale ban on financial stocks and clarified the short position disclosure requirements. Under the FSA disclosure regime, any short seller with a short position in a stock that exceeds 0.25% of the shares outstanding is required to publicly disclose the size of the short position. Further disclosure is required if a short position changes by 0.1% or more of shares outstanding. In other words, additional disclosures would be required at 0.35% of shares outstanding, 0.45%, 0.55%, and so on. If a short position decreases below 0.25%, that must be disclosed as well. Disclosures are due the day after a threshold is reached.

In this letter, we analyze data on all initial disclosures of large short positions in UK financial stocks from January 17, 2009 to April 30, 2011. We do not find a significant stock price effect associated with the first disclosure of a large short position. However,

there is strong evidence that the disclosure of a short position is followed by more short selling. Five to thirty days after an initial disclosure, disclosures of large positions in the same stock by other short sellers are far more likely. Overall short interest also rises in the days following a disclosure, and short sellers pay higher fees to borrow shares.

Our results suggest that hedge funds and other short sellers are piggybacking on the information in a short position disclosure. Over the next few days, these followers appear to pile on with additional large short positions in the same stock. Interestingly, this additional shorting activity does not seem to have any stock price effects, but our results suggest that short position disclosures do have important knock-on effects, and these should be carefully considered by regulators.

Data and Methods

Data Explorers generously provided us with a database of 1,926 UK short position disclosures since September 2008. These were collected from publicly available news sources. For each short position disclosure, we know the date (and often the exact time) of the disclosure, the identity of the short seller, the name and SEDOL of the instrument being sold short, and the percentage of shares outstanding being sold short.

Data Explorers also generously provided us their securities lending database for UK stocks in the FTSE 350 over the same timeframe. Data Explorers collects securities lending data from securities lenders, such as custodians, who lend stock to prime brokers, and their data cover at least 80% of the equity loan transactions in the market. Based on these equity loan transactions, Data Explorers provides a qualitative measure of the fee for borrowing a particular stock on a particular day in the form of a rank variable called DCBS, where rank one indicates the lowest loan fee and rank ten indicates the highest loan fee. CREST, the UK's electronic settlement system, also provides data on equity loan amounts, and we use their equity loan quantities as proxies for short interest.

As noted above, shorting was banned in UK financial stocks from September 18, 2008 through January 16, 2009. In order to avoid any confounding effects from the shorting ban, we only consider short position disclosures after the ban was lifted, from January 17, 2009 through April 30, 2011.

The UK short position disclosure regime applies to both financial stocks and stocks undergoing rights issues. There are a number of additional considerations associated with rights issues, and while we are currently analyzing short position disclosures in those stocks, in this letter we focus only on short position disclosures in financial stocks. Our final sample consists of 22 financial stocks for which the initial disclosed short position was not announced during a rights issue. There are 124 total disclosed positions in these stocks over the period January 17, 2009 to April 30, 2011.

In addition to the variables described above, we add a number of variables for each short sale disclosure. First, we hand collect the geographic location of each of the short sellers by searching the web, and for US domiciled money managers who disclose large short positions in UK stocks, we measure total assets under management based on 13F filings.

Results

Issuer Returns around Disclosure

In Figure I, we plot returns for issuing firms around the date of disclosure. We plot raw returns of disclosed firms and sector-index adjusted excess returns. The plot shows there is very little effect on stock prices when there is a disclosure. Similarly, Table I shows that the returns are not different from zero in a statistical sense. Specifically, a portfolio of disclosed stocks held in a portfolio for 5 days after the disclosure has an average daily excess return of -0.3%. That same portfolio has a daily return of 0.02% if the disclosed stocks are held in the portfolio for 90 days. Neither of these average returns is different from zero in a statistical sense.

Short Interest around Disclosure

When we look at the amount of short selling that takes place around disclosures, we do find an increase. In Figure II, we plot daily short interest from CREST. The data show that after the disclosure of a large short position, there is an increase in short interest. The increase is temporary, and it is consistent with short sellers responding to publicly-disclosed short positions by increasing short positions after the disclosure. This finding is also consistent with our follow-on findings discussed below.

This increase is statistically significant in the 10-day window after the disclosure compared to a set of matched control firms. Specifically, disclosed firms have 0.455% more short interest, as a fraction of shares outstanding, when compared to their non-disclosed counterparts. However, the statistical significance is not very robust; the increase is not statistically significant using other event windows or when we also require an industry match for the control firms.

Borrowing Costs

We see an increase in borrowing costs after the disclosure of a large short position in Figure III. The increase in borrowing costs, as measured by DCBS, is statistically significant in the 5-day window after disclosure with either industry-matched control firms or non-industry-matched control firms. Using non-industry-matched control firms, the borrowing cost is 0.45 rebate rate categories higher for disclosed firms.

The increase in borrowing costs in Figure III is likely related to the increase in short selling discussed above; the increase in demand by short sellers may be driving the increase in borrowing costs.

Follow-on Behavior

We also explore the possibility that a disclosure in a given stock increases the probability of future large short positions in that stock. We model the probability of disclosures using a logit regression model, and the results are detailed in Table II. We find several interesting results. First, the probability of a disclosure on a given day increases 1.5% if there is a disclosure in the same stock within the previous five days. Relative to the unconditional probability of a disclosure of 0.46%, this result shows that if there is a

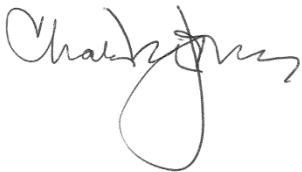
recent disclosure in a particular stock, then there is a 326% increase in the probability that there will be another disclosure in the same stock. It is also interesting to note that the probability of follow-on disclosures is higher if the previous disclosure was made by a short seller with a higher level of assets under management, or by a short seller in either New York or London.

Summary

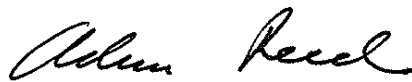
We analyze the recent UK experience with short position disclosure. In this preliminary analysis, we find little effect of short selling disclosures on stock prices. However, we do find evidence that there is follow-on behavior. We find that, for a given stock, the probability of future disclosures increases dramatically when a disclosure is announced. We also find that short interest rises in the days following a disclosure. Our results suggest that short position disclosures do have significant knock-on effects. While the structure of the equity markets in the UK and the US are not identical, we see no reason that a similar disclosure regime would have different effects in the US. We also see no reason that the results on financial stocks wouldn't generalize to stocks in other industries.

Again, thank you for the opportunity to provide input concerning large short position disclosures. We trust you will find the UK's experience instructive as you deliberate in the days and weeks ahead.

Sincerely yours,



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Robert W. Lear Professor of Finance and Economics
Columbia Business School



Adam V. Reed
Julian Price Associate Professor of Finance
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Figure I: Returns Around Disclosure

This graph depicts the average cumulative abnormal returns for disclosed firms in the window surrounding the initial disclosure of a short position in that stock. Disclosed firms are as defined in the text. Daily raw stock returns are from Yahoo! Finance. Excess return is defined as the raw stock return minus the return on the stock's FTSE-sector index from Morningstar Direct.

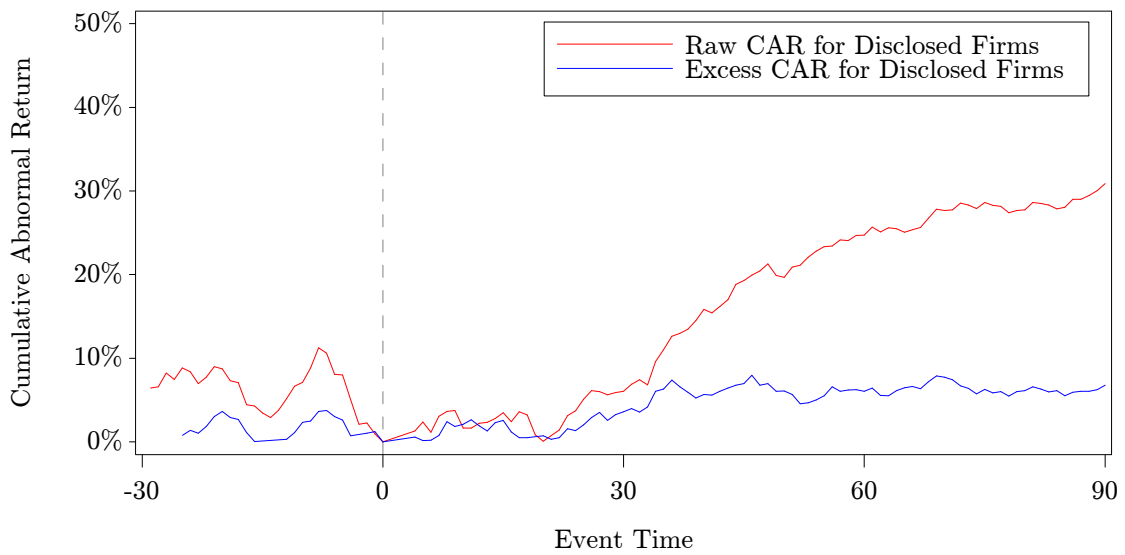
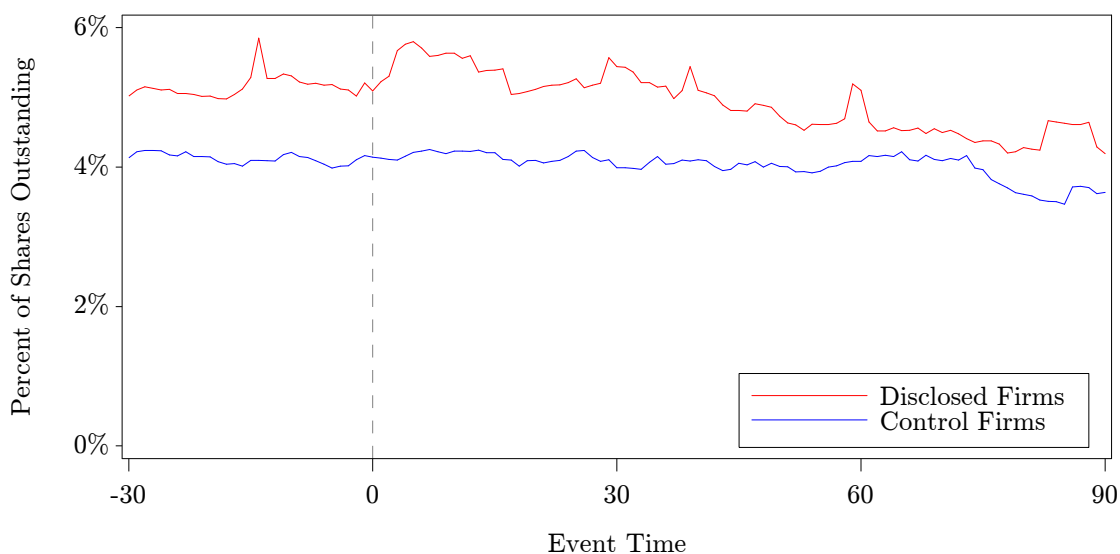


Figure II: Short Interest Around Disclosure

This graph depicts the average short interest for disclosed firms in the window surrounding the initial disclosure of a short position in that stock. Disclosed firms are as defined in the text. In Panel A, each disclosed firm is matched with a control firm in the FTSE 350 index at day 0 by minimizing the sum of the square differences between the disclosed and control firm's share turnover, market capitalization and percentage shares demanded by short sellers from Data Explorers. Panel B additionally requires that the matched firm be a financial stock. Short interest is defined as the total number of shares on loan from the CREST database divided by the number of shares outstanding.

Panel A: Matched Sample



Panel B: Matched Sample Within Financial Industry

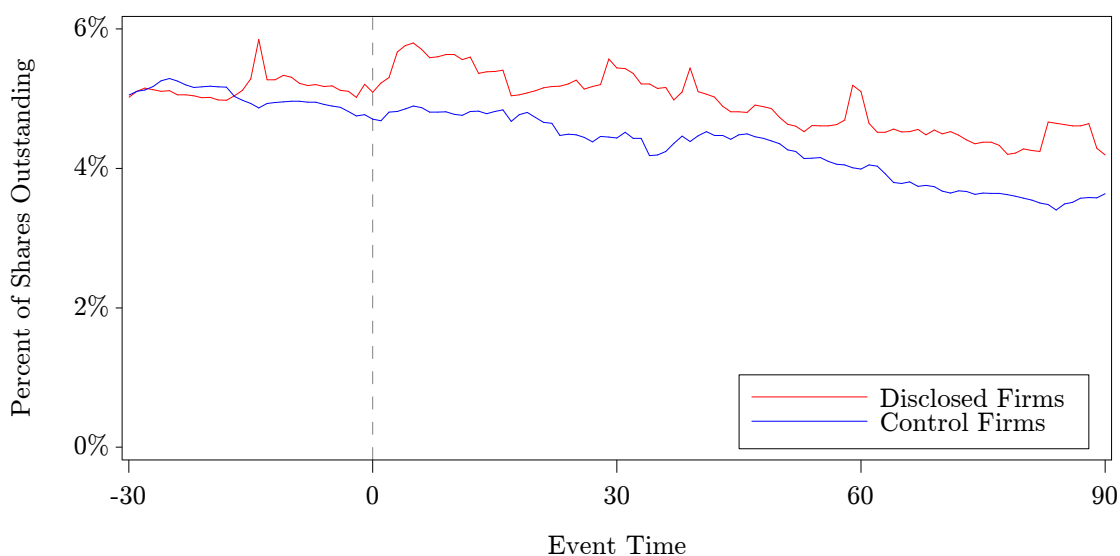
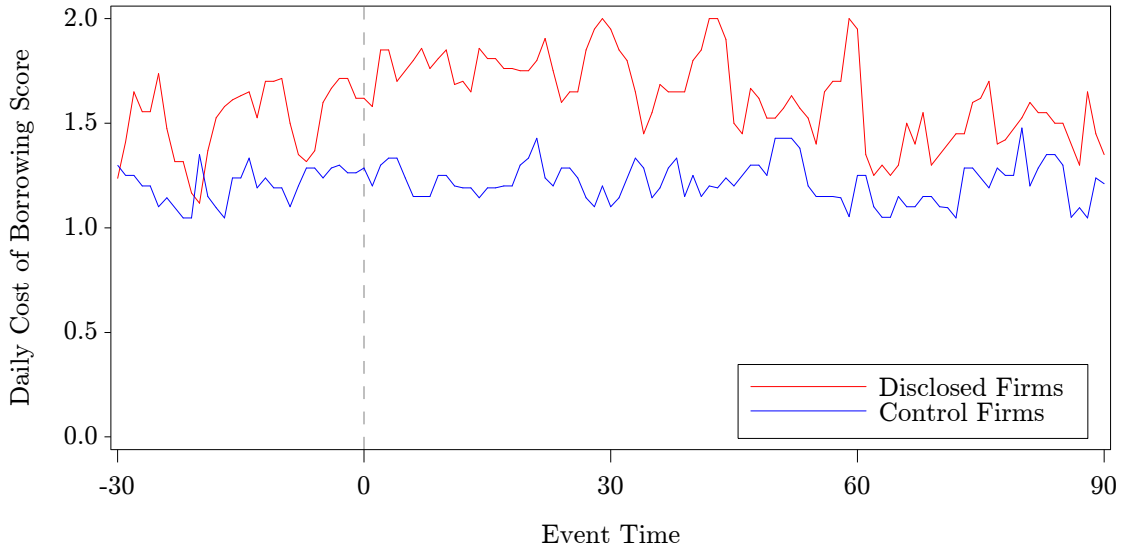


Figure III: Borrowing Cost Around Disclosure

This graph depicts the average borrowing cost for disclosed firms in the window surrounding the initial disclosure of a short position in that stock. Disclosed firms are as defined in the text. In Panel A, each disclosed firm is matched with a control firm in the FTSE 350 index at day 0 by minimizing the sum of the square differences between the disclosed and control firm's share turnover, market capitalization and percentage shares demanded by short sellers from Data Explorers. Panel B additionally requires that the matched firm be a financial stock. Daily cost of borrowing score is a rank variable with fixed bin cutoffs where rank one indicates the lowest loan fees and rank ten indicates the highest loan fee.

Panel A: Matched Sample



Panel B: Matched Sample Within Financial Industry

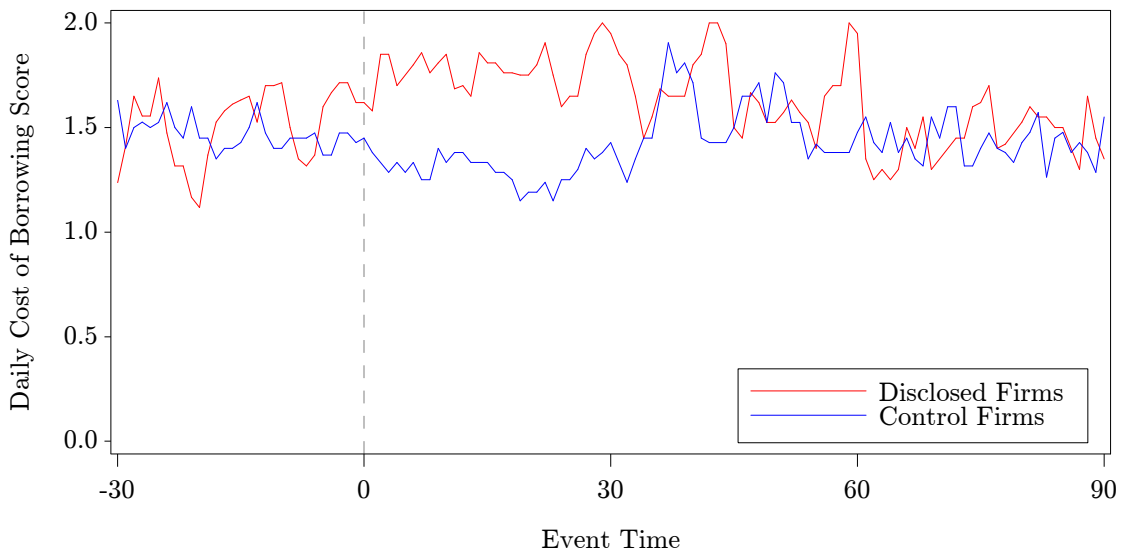


Table I: Abnormal Returns Around Disclosure

This table reports the average daily abnormal returns from a calendar-time portfolio holding disclosed stocks. Relative to the date of stock's initial disclosure, the portfolio is long one share of the disclosed stock for each day in the event window and short one share of the stock's FTSE-sector index. Disclosed firms are as defined in the text. Daily stock returns are from Yahoo! Finance. FTSE-sector index returns are from Morningstar Direct.

Event Window	Abnormal Return	Std Err
(-30, -3)	0.0015	0.0041
(0, 5)	-0.0030	0.0032
(0, 10)	-0.0000	0.0025
(0, 20)	-0.0004	0.0016
(0, 30)	-0.0003	0.0013
(0, 60)	0.0004	0.0011
(0, 90)	0.0002	0.0009

Table II: Likelihood of the Disclosure of a Short Position

This table reports the parameter estimates for a logit model of the disclosure of a short position. The sample includes 26,912 stock-day observations from January 17, 2009 to April 30, 2011 for financial stocks. The dependent variable is a binary variable equal to one if a short position in the stock was disclosed on day t and equal to zero otherwise. Excess Return $_{t-i}$ is the stock daily return in excess of its FTSE-sector index on day $t-i$. Volume (log) is the natural logarithm of the stock's trading volume on day t . Size (log) is the natural logarithm of the stock's market capitalization on day t . Disclosure $_{t-i,t-i-k}$ is a binary variable equal to one if a short position in the stock was disclosed on day $t-i$ to day $t-i-k$ and equal to zero otherwise. AUM is the discloser's most recently reported assets under management (in thousands of dollars) subject to 13F filings. Money Center is a binary variable equal to one if the discloser is headquartered in New York or London and equal to zero otherwise. *, **, and *** denote significance at the 5 percent, 1 percent and 0.1 percent levels respectively.

	Estimate	Marginal Effect	Estimate	Marginal Effect	Estimate	Marginal Effect
Intercept	-5.627**		-4.910*		-5.061**	
Excess Return $_{t-1}$	2.385	0.010	2.245	0.010	1.779	0.008
Excess Return $_{t-2}$	1.976	0.008	1.960	0.008	1.667	0.007
Excess Return $_{t-3}$	-0.786	-0.003	-0.568	-0.002	-0.825	-0.003
Volume (log)	0.217***	0.001	0.207***	0.001	0.220***	0.001
Size (log)	-0.141	-0.001	-0.164	-0.001	-0.165	-0.001
Disclosure $_{t-1,t-5}$	3.610***	0.015	3.253***	0.014	2.631***	0.011
Disclosure $_{t-6,t-30}$	2.287***	0.010	2.143***	0.009	1.904***	0.008
Disclosure $_{t-1,t-5}$ × AUM			0.060**	0.000		
Disclosure $_{t-6,t-30}$ × AUM			0.029	0.000		
Disclosure $_{t-1,t-5}$ × Money Center					1.535***	0.007
Disclosure $_{t-6,t-30}$ × Money Center					0.771*	0.003