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Securities and Exchange Commission
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Dear Securities and Exchange Commission:

Here are my comments on the proposed short sale reporting study. Section 417(a)(2) of the Dodd Frank Wall Street Reform and Consumer Protection Act requires RiskFin to study various enhanced disclosures with respect to short selling, including "real time short sale positions", as well as enhanced marking of the consolidated tape to reflect various short-selling related transactions. This is in addition to §417(a)(1) which calls for a general study of short selling, including settlement failures.

As an academic, I have a tendency to support enhanced transparency because readily available data makes it easier to perform academic studies. Such studies increase the general understanding of financial markets, leading to improved public policy decisions and thus better functioning capital markets. However, it is important to remember that mandatory disclosures force a breach of financial privacy and represent an expropriation of intellectual property. They also impose a compliance tax on the affected parties. There needs to be an overwhelming public benefit in order to justify using the power of government to force market participants to do what they do not want to do voluntarily. Congress has

[1] I am also on the boards of directors of the EDGA and EDGX stock exchanges. My comments are strictly my own and don't necessarily represent those of Georgetown University, EDGX, EDGA, or anyone else for that matter.

made such a determination several times with respect to financial market information in places such as §13 and §17 of the Securities Exchange Act of 1934. It is up to the Commission to work out the details, keeping in mind the general Congressional mandates in §3(f) to consider efficiency, competition, and capital formation in addition to consumer protection.

When thinking about this study, it is useful to revisit the primary reasons why short selling is often criticized as well as the beneficial uses of short selling. Short selling is associated with much beneficial activity in the markets. Short selling is essential to permit market makers to provide liquidity and for arbitrageurs to keep the prices of related financial instruments in proper alignment. Such beneficial shorting activity likely the majority of short activity, and it would be useful to have the data to be able to document this. As the release notes, nearly 50% of transactions are marked as short.[2]

There are five major concerns with short selling:

1. *Manipulation.* Short selling can be used as part of an order-ignition strategy. By selling a large number of shares at a time when market liquidity is low, such sales can push down prices and trigger the execution of stop-loss orders, option-hedge rebalancing, momentum trading, and margin liquidations, thus pushing prices down further. This enables the short position to be covered at a profit. Clearly, regulators need timely access to good information to permit them to identify who is trading in the market and how they are trading.
2. *Defamation.* While order ignition is a short-term strategy, some short sellers hold positions for long periods of time in the expectation of a major price drop. Even after a price drop, some shorts are reluctant to cover their positions as that would trigger the recognition of the profit for tax purposes. Long-term shorts are often accused of spreading false or misleading information about the firm. Although any artifice to deceive is a violation of the anti-fraud provision of §10(b) of the ’34 Act, it is very difficult to identify and prosecute malicious rumor mongers. Information related to the identity and size of economic short positions – whether in cash equities or derivatives would help to identify those with a motive to engage in defamatory practices.
3. *Piling on.* There is a concern that during times of market stress short sellers might exacerbate a panic by adding additional selling pressure to the market. A better understanding of the role of short selling can help to determine the extent of this problem and what types of market procedures, if any, are needed to contain the damage in such situations.
4. *Empty voting.* It is possible to buy votes without having an economic exposure to the stock price by establishing a long position in one account and hedging that exposure through derivatives or by short selling in another account. Although this practice is probably quite rare in the U.S., it could be used to affect the outcome of close corporate elections. The Commission should take proactive rulemaking steps to make it clear that premeditated empty voting is a manipulative act that violates §10b of the ’34 Act.

[2] It is not clear whether nearly 50% of trades are really short, or whether some hyper-compliant firms with complex trading patterns mark everything as short to avoid the regulatory consequences of accidentally marking a short sale as long.

5. *Settlement failures*. When a seller fails to deliver, they are forcing the buyer into making an involuntary stock loan. The buyer is deprived of the opportunity to earn stock lending revenue and may suffer a loss of voting rights. Although the request for comments was specifically related to section (a)(2), I would like to note that, despite the progress made in cleaning up failures to deliver in cash equities, significant failures remain in ETFs. I suspect that the industry needs smoother mechanisms for creating new ETF shares when needed. I also believe that a system of late fees – similar to what is done in the Treasury market – would be preferable to the current Rule 204.

General Comments:

Better transparency will help to identify abuses by outsourcing analysis.

The SEC has been regularly underfunded, and this situation is unlikely to change in the near future.[3] The SEC is unlikely to get the needed resources to properly analyze and use the data available to it. Thus, it is essential to move as much analysis and enforcement as possible outside of the SEC and moving it to other places such as FINRA. By making more data available to the general public, there is a higher likelihood that independent observers will analyze the data and raise concerns when needed. Thus, the default should be to make as much of the disclosed data public as possible, except where there are legitimate privacy concerns.

Better transparency will help to preserve the market's reputation.

Blaming short sellers is one of the standard tools in the scoundrel's toolbox. While there have certainly been abuses by short sellers, the most notorious of which was the Contac poisoning case, short sellers are often improperly blamed for crimes they have not committed. [4] Unfortunately, this means that those with legitimate complaints about short sellers are often ignored by the regulators or treated as lunatics. Better information about the quantity and nature of short selling will demonstrate when the market is functioning properly and not being manipulated. This is important for establishing and preserving investor confidence in the integrity of the market mechanism.

Position reporting should reflect short and derivative positions.

In the modern world, investors can hold exposure to a security in many ways, both by owning or shorting the security outright, as well as through derivative positions. Given the Congressional determination that certain classes of market participants, such as large institutions, 5% holders, officers, and directors,

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[3] The cumulative total of the SEC's budget since its inception, even when figuring in inflation, is less than investor losses from one Bernie Madoff.

[4] For some information on the Contac case, see for example http://articles.latimes.com/1986-05-30/news/mn-8505_1_warfarin.

should report their holdings, it just makes sense that these holdings – represented by net economic exposure -- be reported regardless of their form.

Investors with legitimate confidentiality concerns should be protected.

Some investors have legitimate confidentiality concerns that full disclosure of their exposures will reveal important information. Indeed, in some cases reporting the long, short, and derivative positions may give away the strategy used to arrive at the positions, which could lead to long-term harm to the investor. The Commission has existing policies that provide for confidential treatment in such cases and these policies should be used to protect those with legitimate confidentiality concerns.

Real-time information is useful only for high-frequency traders.

Short position and short transaction data do not need to be disseminated to the public in real time. Real time data would be most useful to the most sophisticated high-frequency traders who could make use of it in their trading decisions. It is highly unlikely that issuers or regulatory agencies would be able to make use of the data in real-time.

Real-time reporting of short transactions is feasible. Indeed, this information is already collected by the exchanges in real time and could easily be attached to the consolidated tape. However, the real time collection of short positions would likely result in substantial compliance costs for little benefit.

Delaying release of the data reduces the cost of expropriation.

The proprietary value of financial information decays rapidly with time, so delaying the release of the data reduces the expropriation costs that mandated disclosures impose on those forced to disclose.

Pilot experiments are good if they don't cost too much.

Gathering data with well-designed pilot experiments can inform the rulemaking process and result in much better public policy decisions. Section 417(a)(2)(B) calls for a study of a voluntary pilot in which trades are publicly marked with various designations. Some of these marks (long/short) already exist in current data feeds and can be publicly displayed at little cost. My recollection from my days at the NASD a decade ago is that NASDAQ's internal data feeds contain a field indicating whether trades were "proprietary" or not, so such information should be almost easy to gather.

Other data, such as "buy to cover" would result in additional cost. This might be very costly to gather accurately because of the complexity of many trading operations. For example, a co-located server at dark pool's data center that responds to a customer sell order by buying at a price above the NBBO might not have accurate-to-the-nanosecond information as to whether the firm is long or short that security firm wide. Given the large number of trades already marked short, it is unlikely that there will be much useful information in "buy to cover" marks unless the information is also attached to information about the identity of the trader. It would be extremely interesting to gather statistics on the longevity of short positions.

Speaking of time stamps, the data should be time stamped at least to the millisecond or even nanosecond.

The voluntary nature of the proposed pilot also provides methodological concerns. The volunteer companies may not be a representative sample of firms, and there could be a significant selection bias. If there are not enough volunteer companies at first in a needed segment, I am sure that a few gentle requests from the SEC to selected companies will yield enough volunteers. To make sure that there is a good control sample, there should be a limit on the number of pilot firms. Given the excellent job the SEC staff did with the original short sale pilot for Reg SHO, I have complete confidence that the staff can work around the methodological issues to come up with suitable controls.

Don't neglect the OTCBB and Pink Sheets markets.

There are thousands of public companies traded in the OTCBB and Pink Sheets. Better transparency would help these companies as well. They should be specifically considered in any studies and rulemakings in this area.

What's with this long-term bias?

As in the recent Equity Concept Release, this release also asks about "long-term" investors with the unstated bias that long-term investors are somehow good and everyone else is less than good. Using Adobe Reader to search a pdf file of the Securities Exchange Act of 1934 (amended as of August 11, 2010), I can find the phrase "long-term" only once, and that is in Section 15E concerning NRSROs. There appears to be no statutory mandate for such a bias. There are, however, explicit Congressional mandates in Section 3(f) to consider efficiency, competition, capital formation, and consumer protection.

I myself am a true long-term investor. The bulk of my assets are in my retirement account which I do not intend to touch for many decades. I trade rather infrequently. Yet when I do trade, I am aware that I am much better off because of the eco-system of market makers, arbitrageurs, and others who watch individual stocks much more closely than I do. They insure that I have much lower trading costs and much more accurate prices than if such short-term (or –gasp – "high frequency"!) participants were not in the market. I believe that any actions that are intended to benefit long-term investors like me over short-term participants will have the unintended consequence of harming long-term investors like me by damaging the infrastructure of short-term participants who provide us with low transactions costs and liquidity.

Great job on the international thinking!

I am extremely pleased with the discussion on page 7 of the release that the Commission is starting to pay formal attention to what is going on in the rest of the world. It is essential that as part of the

Congressionally mandated studies the Commission report on what the rest of the world is doing. The United States is not the only jurisdiction to consider these issues, and we can learn from the experience of the rest of the world. Formally surveying and reporting what the rest of the world is doing will not only help produce better policy thinking within the Commission, but such formal reports will also help to inform regulators, academics, and others around the world.

Respectfully submitted,

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