R. Cromwell Coulson
Chairman and CEO

May 26, 2009

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

Subject: Proposed Amendments to Regulation SHO
File No. S7-08-09

Dear Ms. Murphy,

Pink OTC Markets Inc. ("Pink OTC", formerly Pink Sheets LLC) respectfully submits the following comments on proposed amendments to Regulation SHO under the Securities Exchange Act of 1934 (the "Exchange Act"), which consist of five different proposals to reinstate some version of the pre-2007 rule that prohibited short sales of exchange-traded stocks on an uptick. We believe that if some version of the rule eventually is adopted, it should also apply uniformly to the markets for OTC equity securities.

Pink OTC is the leading provider of pricing and financial information for the over-the-counter ("OTC") securities markets. Among other things, Pink OTC operates Pink Quote, a real-time Inter-Dealer Quotation System for OTC equity securities for market makers and other broker-dealers registered with the Financial Industry Regulatory Authority ("FINRA").

We support efforts by the Commission to restore investor confidence and calm the recent volatility in the U.S. markets. However, with the institution of Reg NMS, there have been significant changes in trading practices in all U.S. equity markets since the elimination of the uptick rule in July 2007. As a result, we have serious doubts whether any of the proposed amendments can be effectively implemented without market disruption and completely undoing the salutary, and Congressionally-mandated, changes required under Reg NMS. We believe that the Commission should move extremely carefully as any rule changes need to be firmly supported by fundamental data rather than the highly charged political outcry against short selling. As the last half of 2008 proved, rash changes to short selling rules can easily harm liquidity and damage the efficiency of equity markets.

Nonetheless, we believe that any rule adopted by the Commission for national market system (NMS) stocks should also apply to trading in OTC equity securities. Imposing a different rule for OTC equity securities would



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cause investors to have inappropriately negative views about the OTC equity markets and the firms that participate in them.

Accordingly, we believe the short sale restriction applicable to trading in the OTC equity markets that best accomplishes the Commission's goals would (i) prohibit short sales in OTC equity securities that are not published on an inter-dealer quotation system, such as our Pink Quote system or FINRA's OTC Bulletin Board (OTCBB®), (ii) base its price test on the national best bid and (iii) include an exemption for bona fide market making activity.

## I. Application of Short Sale Restrictions to OTC Equity Securities

Any version of the uptick rule for short sales that is applied to NMS stocks should also regulate trading in OTC equity securities. If the Commission finds that a short sale restriction is necessary to restore investor confidence and is therefore in the public interest, then the same restriction should apply to NMS stocks and OTC equity securities. Excluding OTC equity securities from a restriction applicable to NMS stocks that has been found by the Commission to be in the public interest would suggest that investors will not be treated fairly by OTC market participants. This invidious distinction would reduce confidence in the OTC markets, unjustly punishing the issuers of OTC equity securities and casting a cloud over the hard-working employees of brokerage firms who serve clients interested in these investments.

Many issuers of OTC securities are small, emerging growth companies that may need to finance their operations through future sales of securities. If the Commission determines that issuers of NMS stocks require the protection of a short sale restriction to ensure their long-term survival, excluding issuers of OTC equity securities from the same protections may cause investors to doubt their viability. These uncertainties would increase the difficulty of raising capital for issuers of OTC equity securities. In turn, the increased difficulty raising capital may unfairly impede issuers of OTC equity securities from developing into innovative, growth companies that will lead the financial markets in coming years.

A uniform short sale rule covering all equity securities traded in U.S. markets would also reduce systems and compliance burdens for market participants. Any rule adopted by the Commission would require each participating broker-dealer to engineer programs and systems designed to ensure compliance with the new short sale restrictions. If non-NMS, OTC equity securities are excluded from the rule, broker-dealers will need to create two different systems and procedures for the securities traded under each set of rules. A uniform rule would reduce this expense and ease each broker-dealer's burden of compliance.



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## II. Relative Advantages of National Best Bid Test

We concur with the Commission's belief that a short sale price test based on the national best bid (a "bid test") is the only practical alternative under current market conditions, as compared to a test based on last sale price (a "tick test"). In approving the National Association of Securities Dealers' ("NASD")[1] proposal to institute a bid test in 1992 for Nasdaq securities, the Commission noted that a tick test requires the existence of a market environment where transactions are executed at one location and reported sequentially.[2] None of the markets for NMS stocks or OTC equity securities satisfy these essential requirements. Instead, transactions are executed in multiple locations and reported out of sequence. The proposed modified uptick rule, which is a bid test, is the only feasible method of imposing a price test on short sales under current market structures.

It is true that, in contrast to NMS stocks, there is currently no system for the collection, consolidation and dissemination of the national best bid and offer for OTC equity securities, which is an essential component of any bid test. To facilitate covering non-NMS, OTC equity securities under the proposed modified uptick rule, Pink OTC would be willing to join the current Tape C UTP network or work with FINRA to create an OTC/UTP Plan including the best bid and offer prices for securities quoted on OTCBB and our Pink Quote Inter-Dealer Quotation System.

We currently employ the necessary technology to collect best bid information for all securities quoted on Pink Quote. The Commission's proposed three-month implementation period should provide sufficient time for us to join or create a national plan with FINRA for disseminating consolidated best bid information for OTC equity securities quoted on OTCBB and Pink Quote.

At present, neither OTCBB nor Pink OTC can provide best bid information for OTC equity securities quoted on the grey market. If the Commission determines that a short sale price test is necessary to restore investor confidence, the same rule should govern trading in the entire OTC equity market, including securities quoted in the grey market. Short sales in grey market securities should not be permitted unless they are quoted on an electronic quote montage or inter-dealer quotation system and consolidated with all other quotations collected, consolidated and disseminated to market participants through an appropriate market plan. The implementation of this

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[1] NASD is now known as FINRA.

[2] SEC Release No. 34-34277, June 29, 1994.



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requirement would increase the transparency of grey market securities and permit uniform regulatory oversight of the entire OTC equity market.

## III. **Exemption for Bona Fide Market Making Activity**

We respectfully disagree with the Commission's decision not to propose an exemption for bona fide market making activity. One unintended consequence of a short sale restriction without a bona fide market maker exemption would be to eliminate a market in many smaller, illiquid issues. Such a result would be contrary to the interests of the investing public and frustrate the successful capitalization of smaller companies.

In the absence of a bona fide market maker exemption, a market maker would only be allowed to maintain a two-side quote during those times that it holds an inventory of quoted securities. The proposed amendments would require market makers to withdraw from the market during times when their inventory of quoted securities was exhausted.

Many OTC equity securities are quoted by one or two market makers on our Pink Quote system. Many securities listed on the New York Stock Exchange or Nasdaq are also quoted by relatively few market makers. The withdrawal of these market makers during times of inventory depletion is likely to eliminate a two-sided market in these securities. OTC equity markets would suffer a severe reduction in the number of market makers and consist almost entirely of one-sided quotes. The reduction in market makers could create difficulty borrowing any OTC equity security, leading to a further loss of liquidity for the securities of OTC issuers.

On the other hand, a bona fide market maker exemption would allow market makers to continuously post two-sided, priced quotes, including times when they did not have any inventory in the security, thereby providing continuous market liquidity and preventing market disruption.

Moreover, market makers in the OTC markets generally cannot use market indices to hedge their short-term exposure to long positions because there are no market index securities products sufficiently narrow in scope to be useful for hedging that cover OTC equity securities. Instead, OTC market makers hedge by selling short OTC equity securities against their long positions in comparable OTC equity securities. By creating a balanced short and long portfolio of OTC equity securities, OTC market makers are able to



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offer tighter spreads and employ more capital on both the short and long side. Without an exemption for bona fide market making activity, market makers would be forced to liquidate their long positions. This would raise costs and risks for OTC market makers, remove additional long liquidity from the market, and increase bid ask spreads for investors in OTC equity securities, all which would be contrary to the Commission's goals.

To ensure that a bona fide market maker exemption does not lead to manipulative short selling practices, we believe the Commission should define "bona fide market making activity" as requiring the maintenance of continuous two-sided, priced quotes in the security being sold short. Historical experience demonstrates that the bona fide market maker exemption from the Nasdaq's bid test encouraged broker-dealers to maintain continuous, liquid markets, while deterring speculative selling and other spurious practices from the exemption.[3] As a result, relatively liquid markets were maintained in the securities of smaller, emerging issuers. We believe that a similar short sale regulatory structure would permit the market for OTC equity securities to thrive in much the same way.

**Conclusion**

We have substantial doubts as to whether a short sale price rule is in the public interest under current market structures. Nonetheless, we believe that any rule adopted by the Commission should uniformly cover all equity securities traded in the U.S. markets. We do not believe the reinstatement of the former uptick rule is feasible under current market conditions, which are characterized by quotations and executions occurring simultaneously in several venues. Accordingly, the proposed modified uptick rule is the only feasible way to impose a price test on short sales at the present time. Finally, an exemption is required for bona fide market making activity to facilitate continuous two-sided securities markets, which are necessary to avoid market disruption.

Please call me if you have any questions.

Very truly yours,

R. Cromwell Coulson
Chief Executive Officer

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[3] NASD Notice to Members 06-53, September 2006.



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