June 7, 2009

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

Ref. File No: S7-08-09

Dear Mrs. Murphy,

This letter briefly highlights two reasons why the reinstatement of the uptick rule should be abnegated by the SEC. It also underlines the fallacies voiced by the opposition and illustrates how short sale restrictions negatively impact legitimate short selling.

The first reason for preventing the reinstatement of the uptick rule is simply a lack of empirical data which supports its efficacy. The data from a Pilot study, conducted by the Commission in 2004, revealed: 1) 'limited evidence that price test restrictions distort a security's price' and that 2) 'short sale price test restrictions…act as a constraint to [legitimate] short selling' (14). One of the most crucial findings of this study was that there was no significant difference in short interest positions between securities subject to the uptick rule and those that were not. An example of the latter finding occurred recently in 2008 when the temporary short sale ban (effective between September 19th and October 9th) had no effect on the financial sector which still cascaded down over 30%, despite the enactment of these restrictions.

Critics of the data believe that the Pilot study was conducted during a time when volatility in the market was low and bull market sentiment was high, arguing that the testing of this rule in a stable market environment skewed the validity of the results. However, the SEC notes that 13 other analyses of short selling restrictions were conducted between 1963 and 2004, several of which occurred during periods of 'severe market decline' (15). Thus far, empirical data has only strengthened the case for the removal of short sale price restrictions.

The second reason for eliminating the uptick rule is because selling short provides the market with much needed liquidity and pricing efficiency. For example, selling short mitigates temporary imbalances in the buying and selling interest of a stock and provides liquidity in response to an unanticipated demand for a stock. Short selling inhibits the price of a stock being artificially inflated, especially in cases of upward stock manipulation. A ban on short selling would exacerbate an increasing market for a security by putting pressure on the buy side.

Selling short is also instrumental in hedging trades as a way to decrease risk and add a form of insurance to arbitrage strategies. Having the ammunition to hedge a trade/ portfolio levels the playing field for all those involved in the random walk of the markets.

Proponents of the uptick rule claim that 'bear raids' are imminent without short sale price restrictions and that investor confidence would crumble amidst severe market volatility (16). On the contrary, market surveillance and increased transparency would be integral to exposing short sale manipulation *and* buying manipulation too. Short selling restrictions would artificially prop up securities, thus, removing elasticity in markets and violating the law of supply and demand. During the late 1990's, investors witnessed this over-inflated pricing behavior during the Tech Bubble.

Interestingly, the SEC notes that false rumors regarding 'financial institutions of significance' fuelled market volatility, not short selling in and of itself (21). The SEC's July Emergency Order further notes that 'false rumors can lead to a loss of confidence in markets' which consequently can lead to panic selling (21). It is necessary here to bifurcate cause and effect; that is, the *cause* of market decline stemming from false rumors and the *effect* of these rumors being short selling. Rather than reigning in short selling, which carries deeper implications for market liquidity and price efficiency, the SEC should focus their reform policies on the *cause* of recent market hysteria. A comment by Warren Buffet lends credence to this point; '*With each passing year, the noise level in the stock market rises. Television commentators, financial writers, analysts, and market strategists are all overtaking each other to get investors' attention. At the same time, individual investors, immersed in chat rooms and message boards, are exchanging questionable and often misleading tips*.'[1]

Efforts to eliminate misleading market noise should be a priority for the SEC rather than reinstating restrictions on short selling which have no empirical data to support its effectiveness. The SEC should recognize that a ban on short selling becomes a form of market manipulation in that it prevents the natural ebb and flow of the market's invisible hand. For all the aforementioned reasons, I request that the SEC not reinstate the uptick rule.

Sincerely,

Agnes B. Gambill

References:

SECURITIES AND EXCHANGE COMMISSION. 17 CFR PART 242
http://www.sec.gov/rules/proposed/2009/34-59748.pdf

[1] ^ Hagstrom, Robert G. (2001). *The Essential Buffett: Timeless Principles for the New Economy*. New York: John Wiley & Sons. ISBN 0-471-22703-X.