SIFMA
Securities Industry and
Financial Markets Association

June 19, 2009

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

Re: Release No. 34-59748: File No. S7-08-09;
<u>Proposed Price Test Amendments to Regulation SHO</u>

Dear Ms. Murphy:

The Securities Industry and Financial Markets Association ("SIFMA")[1] appreciates the opportunity to comment on the Securities and Exchange Commission's (the "SEC" or "Commission") proposed amendments to Regulation SHO ("the Release").[2] The Commission has requested comment on whether, in light of recent market conditions and events, it should re-instate "price test" restrictions on short sales, which were eliminated in their entirety in 2007. In this regard, the Commission has proposed to amend Regulation SHO by implementing one of five alternative price test restrictions on short selling: (i) a market-wide short sale price test based on the National Best Bid ("NBB") ("proposed modified uptick rule"); (ii) a market-wide short sale price test based on the last sale price (or tick) ("proposed uptick rule," which is similar to former Rule 10a-1); (iii) a circuit breaker that would ban short selling in a particular security for the remainder of the day if there is a severe decline in the price of that security ("proposed circuit breaker halt rule"); (iv) a circuit breaker that would impose a short sale price test based on the NBB in a particular security for the remainder of the day if there is a severe decline in the price of that security ("proposed circuit breaker modified uptick rule"); or (v) a circuit breaker that would impose a short sale price test based on the last sale price in a particular security for the remainder of the day if there is a severe decline in the price of that security ("proposed circuit breaker uptick rule").

1 The Securities Industry and Financial Markets Association brings together the shared interests of more than 600 securities firms, banks and asset managers. SIFMA's mission is to promote policies and practices that work to expand and perfect markets, foster the development of new products and services and create efficiencies for member firms, while preserving and enhancing the public's trust and confidence in the markets and the industry. SIFMA works to represent its members' interests locally and globally. It has offices in New York, Washington D.C., and London and its associated firm, the Asia Securities Industry and Financial Markets Association, is based in Hong Kong.

2 Securities Exchange Act Release No. 59748 (April 10, 2009), 74 FR 18042 (April 20, 2009) ("Release").

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I. Introduction and Executive Summary

SIFMA firms believe that short selling is a longstanding, legitimate practice that provides numerous benefits to the market. The Commission has recognized the value provided by short selling, noting that:

> [s]hort selling provides the market with at least two important benefits: market liquidity and pricing efficiency. Market liquidity is generally provided through short selling by market professionals…who offset temporary imbalances in the buying and selling interest for securities. Short sales effected in the market add to the selling interest of stock available to purchasers and reduce the risk that the price paid by investors is artificially high because of a temporary contraction of selling interest. Short sellers covering their sales also may add to the buying interest of stock available to sellers…Short selling also can contribute to the pricing efficiency of the equities markets. Efficient markets require that prices fully reflect all buy and sell interest…Market participants who believe a stock is overvalued may engage in short sales in an attempt to profit from a perceived divergence of prices from true economic values. Such short sellers add to stock pricing efficiency because their transactions inform the market of their evaluation of future stock price performance. This evaluation is reflected in the resulting market price of the security.[3]

SIFMA also appreciates that there may be potential abuses associated with short selling, as with many other forms of trading strategies, and thus a need for regulation designed to guard against such abuses. SIFMA notes that, by and large, concerns regarding abusive short selling generally focus on so-called "naked" short selling, which refers to instances of selling short without having located stock available for delivery and intentionally failing to deliver stock within the standard three-day settlement cycle.[4]

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3 Securities Exchange Act Release No. 48709 (October 28, 2003), 68 FR 62972 (November 6, 2003).

4 Securities Exchange Act Release No. 58774 (October 17, 2008), 73 FR 61666 (October 17, 2008). As the Commission staff has specifically noted, not every fail to deliver is caused by "naked" short selling and, furthermore, fails to deliver are not per se manipulative and may not even be improper or illegal. "Failures to deliver may result from either a short or a long sale. There may be legitimate reasons for a failure to deliver. For example, human or mechanical errors or processing delays can result from transferring securities in physical certificate rather than book-entry form, thus causing a failure to deliver on a long sale within the normal three-day settlement period." SEC, *Division of Market Regulation: Key Points About Regulation SHO* (April 11, 2005). The SEC indicated in this same document that "naked" short selling can have many meanings, and is not necessarily manipulative or violative. "Naked short selling is not necessarily a violation of the federal securities laws or the Commission's rules. Indeed, in certain circumstances, naked short selling contributes to market liquidity. For example, broker-dealers that make a market in a security generally stand ready to buy and sell the security on a regular and continuous basis at a publicly quoted price, even when there are no other buyers or sellers. Thus, market makers must sell a security to a buyer even when there are temporary shortages of that security available in the market. This may occur, for example, if there is a sudden surge in buying interest in that security, or if few investors are selling the security at that time. Because it may take a market maker considerable time to purchase or arrange to borrow the security, a market maker engaged in bona fide market making, particularly in a fast-moving market, may

In addition, concerns have arisen, particularly in the summer and autumn of 2008, regarding other potential abusive short selling practices, including market participants possibly combining naked short selling activity with the spreading of false rumors.[5] SIFMA notes that the Commission has taken significant action to address many of the aforementioned potential abuses including, but not limited to, adopting: (i) Rule 204T, which generally requires a clearing firm participant to deliver securities sold on settlement date, or to close out any fail-to-deliver positions by borrowing or purchasing the securities in question; (ii) Rule 10b-21 (the "naked short selling anti-fraud rule"), which is intended to target short sellers who intentionally misrepresent that they have obtained a "locate," or long sellers who misrepresent that they own the securities sold and then fail to deliver; and (iii) Rule 10a-3T, which generally requires disclosure of certain short sales and short positions on a weekly basis. As the Commission noted in the Release, and as further described below, these and other actions have resulted in a number of positive impacts on the market, including drastic reductions in the number of failures to deliver overall, as well as in the number of Threshold Securities.[6]

Nevertheless, the Commission noted in the Release that, despite the fact that it is unaware of any specific empirical evidence that the absence of short sale price test restrictions has contributed to increased volatility or abusive behavior in the U.S. markets or that having such short sale price test restrictions would have avoided or significantly mitigated such volatility and abuses, it has received requests from many commenters, including investors, issuers, and members of Congress, to consider re-imposing short sale price test restrictions, in the belief that such action would help restore investor confidence in the markets and facilitate stable and orderly markets.

As explained in greater detail below, SIFMA's views on this issue can be summarized as follows:

- SIFMA firms share the concerns of all investors and market participants regarding periods of extreme volatility in the securities markets, and understand the need to actively explore the causes of this extreme volatility and to maintain investors' confidence in the securities markets.
- While SIFMA understands and thoroughly supports the Commission's efforts to restore investor confidence and facilitate stable and orderly markets, it does not

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need to sell the security short without having arranged to borrow shares."

5 *See*, *e.g.*, Securities Exchange Act Release No. 58572 (September 17, 2008), 73 FR 54875 (September 23, 2008). "As evidenced by our recent publication of an emergency order under Section 12(k) of the Securities Exchange Act of 1934 (the "July Emergency Order"), we are concerned about the possible unnecessary or artificial price movements based on unfounded rumors regarding the stability of financial institutions and other issuers exacerbated by 'naked' short selling. Our concerns, however, are no longer limited to just the financial institutions that were the subject of the July Emergency Order. In addition, we have become concerned that some persons may take advantage of issuers that have become temporarily weakened by current market conditions to engage in inappropriate short selling in the securities of such issuers."

6 A Threshold Security is defined under Regulation SHO to mean an equity security registered or for which reports are required to be filed with the Commission and for which there is an aggregate fail to deliver position for five consecutive settlement days at a registered clearing agency of 10,000 shares or more and that is equal to at least 0.5% of the issue's total shares outstanding.

believe there is sufficient evidence that these goals would be promoted or achieved in any measurable sense through new short sale price test restrictions.

- SIFMA feels strongly that the re-implementation of any proposed price test restriction should come only after rigorous analysis, and be supported by economic data evidencing a clear market or investor benefit resulting from re-instatement.
- SIFMA acknowledges that many commenters on the Release to date have requested that the Commission re-instate price tests in the belief that such restrictions will serve to curb "naked" short selling abuses. However, we note that the proposed price tests are unrelated to, and not designed to address, abusive "naked" short selling.
- In determining whether price test restrictions are necessary, the Commission should consider the significant positive impacts that have already been achieved through other recent regulatory actions targeting abusive short selling, including Rule 204T, Rule 10b-21, and Rule 10a-3T, and the potential for greater positive impacts through continued enforcement of these existing rules.
- If the Commission does determine, based on its review and analysis of empirical data, that short sale price test restrictions are necessary to, and can, restore investor confidence or further address abuses, then SIFMA believes that any such price test restriction should be narrowly tailored to meet its achieved goals and not result in significant costs to member firms and investors or sacrifice the essential benefits of short selling in the markets.
- SIFMA firms oppose the return of the Commission's former uptick rule based on the last sale, in that such a price test could not function in a post-Regulation NMS regime with fragmented equities markets.
- Although it is not unanimous among SIFMA firms, there is a general consensus that, should the Commission decide a price test is necessary and appropriate, a short sale price test that would be narrowly tailored toward certain stocks that have tripped a circuit breaker, while not impacting trading in other securities that have not tripped that circuit breaker, may have the least negative impact. This option, however, does have certain drawbacks which should be carefully considered, as further discussed below.
- If the Commission were to consider implementing a circuit breaker, there are varying views among member firms as to whether the circuit breaker would have the least negative impact if: (i) it were to trigger a halt in short selling, which would be the easiest to implement, or (ii) it were to trigger a price test based on the NBB. As more fully discussed below, each of these options has drawbacks that should be carefully considered.
- SIFMA firms feel strongly that, if the Commission were to adopt a price test restriction, then whichever alternative is adopted must contain certain essential exceptions to ensure, among other things, the smooth functioning of the markets and that investors and issuers are not negatively impacted. Such exceptions, which are discussed further below, include, without limitation, the following: (i) short sales by market makers engaged in bona-fide market making activity, including market makers in OTC and listed derivatives, options, convertibles and ETFs, and block positioners; (ii) activity excepted from, or necessary to comply

with, Regulation NMS (including ISOs, benchmark orders, etc.); (iii) short sales in connection with the facilitation of capital raising transactions, through both issuances of stock and convertible instruments, by issuers and selling shareholders; (iv) short sales that may result from the exercise or assignment of options; and (v) exchange traded funds and similar broad-based indices and baskets of stocks.

- SIFMA firms strongly believe that, if the Commission were to adopt a price test, then, depending on the form of price test adopted, the Commission should allow SIFMA firms, other market participants, exchanges, trading centers and others sufficient time to review their internal systems, implement necessary IT and other systems changes, modify internal surveillance procedures and make other compliance changes, and adequately test those changes.
- SIFMA firms generally favor a policies and procedures approach to any price test, *i.e.*, a trading center would be required to have written policies and procedures reasonably designed to prevent the execution or display of short sale orders that do not comply with the price test.
- SIFMA notes that a number of commenters to date have recommended that the Commission impose a "pre-borrow" requirement prior to effecting short sales. As explained in detail below, SIFMA urges the Commission not to impose such a requirement, as it could severely impact the many market benefits resulting from legitimate short sale activity, as well as potentially result in numerous other unintended consequences.

SIFMA also notes that many member firms are multi-national financial organizations and, as we have recently experienced, globalization has become a major factor in the soundness of today's capital markets. The deterioration of one nation's economy can drastically affect capital markets world-wide. With this in mind, SIFMA believes that regulatory regimes from different jurisdictions should work together in coordinating efficient markets, and that the Commission therefore should consider these regulatory regimes and their approaches to regulating short selling before choosing a course of action. In this regard, a number of market authorities overseas have expressed similar concerns about potentially abusive short sale practices and have undertaken comprehensive reviews of short selling and regulatory approaches towards short selling. We note that, at least to date, they appear to have determined that the proportionate response to the risks posed by potentially abusive short selling is not through additional constraints such as prohibitions, circuit breakers or tick tests, but rather through regulatory control mechanisms that focus on settlement, disclosure and enforcement, which are similar to Rules 204T, 10b-21 and 10a-3T already adopted in the U.S. equity markets.[7]

We have addressed these and other points in further detail below and have provided our views on the possible positive and negative consequences of the proposed amendments, along with our opinion as to whether the proposed amendments would foster the stated policy goals of the Commission in restoring the markets. In addition, we also address below certain questions raised by the Commission in the Release and respond to the particular structure of the proposed

[7] *See*, *e.g.*, studies from IOSCO and FSA, discussed infra.

amendments under consideration, including recommending exceptions tied to the possible alternative short sale restrictions.

II. Commission should proceed with re-instituting a price test restriction only if supported by economic data and analysis that demonstrates such action will improve market quality without unintended consequences

SIFMA firms commend the Commission on taking a careful and thorough approach in deciding whether to implement any form of short sale price test restriction. This is evidenced by the comprehensive Release and also the Roundtable held on May 5, 2009, where the Commission brought together representatives of self-regulatory organizations, trading venues, the financial services industry, investment firms and the academic community to discuss short sale price tests and circuit breaker restrictions ("Roundtable"). SIFMA feels strongly that the implementation of any proposed form of short sale price test restriction should come only after rigorous analysis and be supported by economic data evidencing a need for instituting such a restriction. SIFMA notes that this view was strongly supported by the statements made by Chairman Schapiro and certain other Commissioners during the Roundtable, as well as by many of the panelists participating in the Roundtable, and at the open meeting held on April 8, 2009 to consider these price test restrictions ("2009 Open Meeting").[8]

In this regard, Chairman Schapiro, in her opening statement before the 2009 Open Meeting, addressed the lack of economic data supporting a need for reinstating a price test by stating that "*we are not aware of specific empirical evidence that the 2007 elimination of short sale price tests contributed to this volatility in the U.S. markets*" and stressing that "*It is important that we obtain informed public comment before determining whether or not to impose any short sale restrictions, and, if so, what those restrictions should be*." [9]

Commissioner Paredes' statement at the 2009 Open Meeting also addressed previous economic studies on short sales, noting "*Careful empirical research by SEC economists and outside academics had found that short sale price tests do not effectively serve their purposes, but do impose costs on markets…*" and *"It is not self-evident that the findings of these economic studies — which supported this agency's prior decision to repeal the "uptick" rule — do not continue to hold in the current economic and financial climate."* [10] Similarly, Commissioner Casey, in addressing whether the repeal of the uptick rule had anything to do with the economic and market conditions of the past 18 months, commented, "*From the empirical studies that we have seen to date, I have not yet been persuaded that the answer is yes."* Commissioner Casey also stressed the need for evidence to support any decision, stating "*empirical evidence must*

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[8] U.S. Securities and Exchange Commission Open Meeting, April 8, 2009.

[9] Chairman Mary L. Schapiro, Opening Statement Before the U.S. Securities and Exchange Commission Open Meeting on April 8, 2009.

[10] Commissioner Troy A. Paredes, Statement Before the U.S. Securities and Exchange Commission Open Meeting on April 8, 2009. With respect to the lack of current studies advocating the need to reinstate a price test, Commissioner Paredes noted importantly, "*I am not aware of an empirically-demonstrated link between recent market conditions and the repeal of the "uptick" rule, and it is important to distinguish correlation from causation."* In short, Commissioner Paredes' statement addresses the fact that little empirical evidence has been presented to demonstrate that short sale price test restrictions are warranted and will instill investor confidence in the markets, but that there has been plenty of evidence presented showing they are unnecessary.

guide regulatory decisions," and requested *"any credible empirical evidence demonstrating that eliminating the uptick rule drove down the price of any security."*[11]

In line with these statements, SIFMA believes that the Commission should leverage off of the many existing studies on the impact of short sale price test restrictions, including its own studies by the Commission's Office of Economic Analysis ("OEA") and those of third parties, or invite additional studies by OEA and others if the Commission believes that further information is needed. SIFMA believes that any decision to re-institute a price test needs to directly address the Commission's prior study of the Regulation SHO Pilot ("Pilot Study" or "Pilot") that justified the prior elimination of short sale price test restrictions, and explain why the Pilot Study was either flawed in its findings or did not properly consider the potential impact of removing price test restrictions under adverse market conditions. With respect to this latter point, the Commission should also address the OEA's recent study, discussed infra, noting the impacts that a short sale price test might have had if in place during September 2008.

A. Prior elimination of short sale price tests

In July 2007, the Commission eliminated all short sale price test restrictions, including NASD Rule 3350 and the former uptick rule (Rule 10a-1), the latter of which was previously in effect for nearly 70 years. Prior to elimination, the Commission instituted the Pilot Study, which, for over two years, studied the effects of removing price test restrictions over a limited set of securities.[12] In taking such action, the Commission engaged in a careful and deliberate approach, which was open and transparent to the public at every stage and subject to extensive economic analysis and comment, including by its own economic experts at OEA as well as independent economists and academics. In its February 2007 comment letter responding to the proposed elimination of short sale price tests, SIFMA echoed the Commission's statements at the open meeting held by the Commissioners to consider the Commission Staff's proposals to remove the tick test of Rule 10a-1 as well as all other short sale price tests of any self-regulatory organization. In particular, we noted that the Commission commended the Commission Staff for engaging in a comprehensive process of: (i) selecting a sample of securities to be included in the Pilot; (ii) analyzing data derived from the Pilot in order to determine the potential impacts associated with removing a price test; (iii) presenting its analysis in a public document; and (iv) hosting a Regulation SHO roundtable to facilitate further discussion and analysis of the Pilot.

The Pilot was carefully and methodically designed to enable the Commission and the broader community to evaluate whether removing price restrictions would have a substantive impact on market quality, and more generally to achieve a deeper understanding of how price restrictions affect the trading process.[13] OEA collected data from the Pilot, analyzed such data,

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[11] Commissioner Kathleen L. Casey, Statement Before the U.S. Securities and Exchange Commission Open Meeting on April 8, 2009. Commissioner Casey also commented on prior studies by the Commission's Office of Economic Analysis that found: *"removing price tests had a material effect on short selling volume, the mechanics of short selling, order routing decisions, displayed depth, and intraday volatility, supporting the view that eliminating the price tests would reduce these market distortions. The study also tested for signs of "bear raids," but found no indication that removing the price tests was associated with increased market manipulation."*

[12] Securities Exchange Act Release No. 50104 (July 28, 2004), 69 FR 48032 (August 6, 2004).

[13] OEA Study: "Economic Analysis of the Short Sale Price Restrictions Under the Regulation SHO Pilot," February 6, 2007. Available at: http://www.sec.gov/news/studies/2007/regshopilot020607.pdf.

and issued a report providing its results. Data from the Pilot was also provided publicly, in order to allow others to examine the data and perform their own analysis. The OEA report issued on February 6, 2007 presented the following results:

- Price test restrictions reduce the volume of executed short sales relative to total volume, demonstrating that price restrictions act as a constraint to short selling.
- Price test restrictions "affect the ability of short sellers to demand liquidity by getting prompt execution of market orders."[14]
- No evidence was found that "the Pilot has had any impact on the level of trading activity in the options market, as we would have expected to see if market participants are using options markets to avoid the tick test or the bid test," and that "other than the effect on market depth, the Pilot has had no clear effect on market liquidity—most of our tests indicate that liquidity was not significantly impacted by the Pilot, but some tests indicate small increases or decreases in liquidity, depending on the measure."[15]
- In summary, OEA concluded that "price test restrictions constitute an economically relevant constraint on short selling" and "evidence suggests that removing price test restrictions for the pilot stocks has had an effect on the mechanics of short selling, order routing decisions, displayed depth, and intraday volatility, but on balance has not had a deleterious impact on market quality or liquidity."[16]

On balance, the Pilot results provided little evidence suggesting that the removal of price test restrictions would encourage market volatility, or harm price efficiency or liquidity. Indeed, as noted by the Commission in the release proposing the removal of price test restrictions, the OEA report suggested that price test restrictions may in fact have a larger *negative* than *positive* impact on the markets, noting in particular that: (i) price test restrictions result in decreased short selling volume, thus depriving the marketplace of important benefits such as liquidity and price efficiency; and (ii) price test restrictions result in market participants routing orders to market centers that do not have price tests, thereby resulting in a loss of trading volume for market centers that in fact have a price test, as well as encouraging regulatory arbitrage.[17]

Perhaps most importantly, the Pilot data did not indicate any association between manipulative short selling, such as "bear raids," and price test restrictions.[18] The empirical analyses of the Pilot not only provided support for removing price test restrictions for large or actively-traded securities, but also did not provide support for extending price test restrictions to small or thinly-traded securities. In summary, OEA found little empirical justification for maintaining any price test restrictions.

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14 *Id. at p. 6.*

15 *Id.* at p. 7.

16 *Id.* at pp. 55-56.

17 71 FR at 75075.

18 *Id.* (noting that the OEA Staff's Draft Summary Pilot Report did not evidence an increase in manipulative short selling during the time period studied).

We also point to an independent study examining the effects of the Commission Pilot study, which found that while short selling activity increased for the Pilot stocks, daily levels of return and volatility remained unaffected.[19] The study noted that the suspension of the price tests made it easier to execute short sales and found only minor differences between changes in market quality measures for Pilot stocks as compared to control stocks. The study concluded with the authors' belief that price tests can safely be suspended on a permanent basis.

SIFMA believes that, in the less than two years after the Commission eliminated price test restrictions, no empirical evidence has been produced to support the proposition that OEA's earlier findings were incorrect and/or did not properly account for periods of market duress. More specifically, while the Commission in its Release cited the recent market volatility as well as the significant decline in the Dow Jones Industrial Average and stock price of individual issuers, it also was careful to note that it was unaware of these effects being caused by the absence of price test restrictions, a position supported by a study conducted more recently by OEA. SIFMA thus believes that, if the Commission acts without taking the same deliberate and analytical approach it took in the past, our markets could be negatively impacted and investors may lose further confidence in the markets. Therefore, SIFMA strongly urges that the implementation of any short sale price test restriction come only after rigorous analysis and be supported by economic data evidencing a need for reinstatement and minimal, if any, negative impact on our markets – in other words, the Commission should undertake a study comparable to its efforts in connection with the prior elimination of the tick test. Only such a measured approach before acting and putting into place a price test will ensure market quality and efficiency.

B. Studies of how a price test would have performed during recent market decline

A number of recent studies have also been conducted to examine the effects of short sale price tests and their impact on market quality. The recent OEA study mentioned earlier examined the extent to which short selling appeared to drive prices downward during the first weeks of September 2008, and whether there existed an association between measures of short selling activity and stock returns. In particular, this study examined whether periods of negative returns are associated with unusually high short selling activity. The results of the study were inconsistent with the notion that episodes of negative returns are the result of short selling activity, and found that, on average, short sale volume as a percentage of total volume was greater for periods of positive returns than for periods of negative returns. Further, the study found that, during periods of extreme negative returns, sell pressure was more intense for long sales, thus indicating that short sales put less pressure on prices than did long sales during periods of extreme negative returns.[20] In fact, the study found that the short sale ratio is mostly higher during periods of positive returns than during periods of negative returns, which is consistent with a finding that short sales are, in part, a tool of price discovery; in other words, higher intensity of short selling is associated with higher returns. The results of this OEA study thus suggest that a substantial fraction of short sale volume is not associated with negative returns and that short selling is not merely a tool for driving prices down.

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[19] Diether, Lee & Werner, "It's SHO Time! Short-Sale Price-Tests and Market Quality," November 2007.

[20] OEA Study: "Analysis of Short Selling Activity during the First Weeks of September 2008," December 16, 2008. Available at: http://www.sec.gov/comments/s7-08-09/s70809-369.pdf.

Another recent OEA study analyzed how short selling restrictions from a "liquidity add plus uptick" rule would vary for stocks with different characteristics, under different price increments ("bid increments"), and for different market conditions. This study found that the restrictions imposed by such a "liquidity add plus uptick" rule would be more restrictive for lower priced stocks and for more active and highly liquid stocks, and would be most restrictive during periods with little volatility. Further, the price test would be less restrictive on short sale orders during periods of large positive returns and large negative returns, though the restrictions would be greater in rapidly declining markets compared to rapidly advancing markets. In addition, the study showed that even moderate changes in bid increments can have a big impact on the constraints imposed on short selling activity, indicating that a one cent increment would be restrictive for more than 60% of the short sales submitted.[21]

This study's statistics thus suggest that, for practical purposes, high bid increments, such as five or ten cents, might be equivalent to a ban on short selling in some stocks, especially during periods when prices are not changing rapidly. Finally, the study indicated that a short sale price test would limit the prices at which short sales could be submitted, would restrict the submission and execution rate of short sale orders, and would effectively create a "minimum shortable price" below which no short sales could be priced. Such restrictions suggest that a short sale price test would affect market quality and limit available liquidity by constraining the opportunities to execute a short sale. The findings of this OEA study therefore seem to indicate that a short sale price test would result in negative consequences for market quality, liquidity and price discovery, contrary to what the Commission would like to achieve with the proposed amendments.

C. Comments from the Roundtable

SIFMA also notes that virtually all academic panelists participating in the Roundtable generally agreed that short sale price tests should not be implemented and may in fact be harmful. Dr. James Angel, professor at Georgetown University, remarked that the Commission did the right thing in removing the old uptick rule, and stated his belief that short sellers did not cause our current financial problems.[22] Dr. Angel noted that, while the Commission's previous Pilot overall could be said to have been conducted during a period of low volatility, individual stocks during this period still experienced volatility and therefore the validity of the Pilot should not be questioned on this basis alone.

Dr. Charles Jones, professor at Columbia Business School, similarly remarked that repeal of the uptick rule did not impact stock price levels or liquidity, and that short sales are typically blamed for market declines while the weak fundamentals of companies most impacted by short sales are often overlooked. Dr. Ingrid Werner, professor at Ohio State University, remarked that recent studies indicate that a tick test would not have a positive impact in a declining market, and recommended that the SEC focus on enforcing its existing rules such as Rules 204T and 10b-21

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[21] OEA Study: "Analysis of a short sale price test using intraday quote and trade data," December 17, 2008. Available at: http://www.sec.gov/comments/s7-08-09/s70809-368.pdf.

[22] James J. Angel, Georgetown University, Opening Remarks at SEC Roundtable on Short Selling, May 5, 2009. Available at: http://www.sec.gov/comments/4-581/4581-2.pdf.

and encourage greater transparency. Dr. Werner also referred to studies that suggest that short sale restraints are less effective when they are needed most in down markets. Dr. Frank Hatheway, chief economist at Nasdaq, affirmed the effectiveness of the recently enacted rules by remarking that Rule 204T reduced fails by 98% in just 8 months.

The only academic who held a slightly different view was Dr. Robert Shapiro of Sonecon, LLC, who appeared to generally concede that short sales did not cause bear markets, but believed "naked" short sales may impact the manner of market decline. Dr. Shapiro referred to fails from a limited period of time – the first calendar quarter of 2008 only – and concluded that most fails during this brief period (approximately 70%) were highly concentrated in about 100 firms. However, we note that his study appears to concern a period of time prior to the adoption of Rule 204T, Rule 10b-21 and other additional regulatory actions taken to address potential naked short selling and fails to deliver, and thus does not consider the positive impacts of those rules, as discussed below.

D. Other studies on the impact of the Commission's short sale emergency orders

One paper recently published on the Commission's September 2008 Emergency Order banning short sales in nearly 1,000 financial stocks studied changes in stock prices, the rate of short sales, the aggressiveness of short sellers, and various liquidity measures before, during and after the short sale ban.[23] This study found that the shorting ban was associated with a sharp increase in share prices for the affected stocks and a drop in shorting activity of 85%. However, the study also found that stocks subject to the ban suffered a severe degradation in market quality, as measured and indicated by wider spreads, larger price impacts, greater intraday volatility, and less liquidity.

In March 2009, the International Organization of Securities Commissions ("IOSCO"), a leading international policy forum for securities regulators, published a consultation paper concerning short selling and regulatory approaches to address abusive short selling. The IOSCO paper indicated support for short selling as an effective tool for improving price discovery, and recommended four main principles in dealing with short selling abuses: (1) appropriate controls to reduce or minimize the potential risks that could affect the orderly and efficient functioning and stability of financial markets, with a minimum requirement of imposing strict settlement; (2) a reporting regime that provides timely information to the market or to market authorities; (3) an effective compliance and enforcement system, to allow for monitoring and inspecting settlement failures and identifying potential market abuses and systemic risk; and (4) the allowance of appropriate exceptions for certain types of transactions for efficient market functioning and development. Of note is the fact that IOSCO does not make a recommendation for reinstating any price test restriction.

In addition, the Financial Services Authority ("FSA") published a discussion paper in February 2009 that reviewed the FSA's temporary short selling measures in September 2008 in relation to stocks in the UK financial sector. The FSA relied on an extensive number of economic studies of short selling generally and short sale restrictions in the US and UK in order

23 Boehmer, Jones and Zhang, "Shackling Short Sellers: The 2008 Shorting Ban," November 2008.

to formulate its recommendations.[24] The FSA discussion paper examined the pros and cons of short selling and re-affirmed its long standing belief that short selling is normally a legitimate trading activity that tends to enhance price efficiency and liquidity, while short sale restrictions impose a cost of reduced market efficiency. Although the FSA affirmed that short selling can be used to commit market abuse and can contribute to disorderly markets, the discussion paper concluded that constraints on short selling, such as a blanket ban on shorting, a ban restricted to "naked" short selling, circuit breakers and tick rules, do not represent proportionate responses to the risks posed by short selling. The FSA concluded that enhanced transparency of positions in specific stocks by individual position holders through a disclosure regime would be the best approach. In short, the paper outlined the FSA's belief that the benefits of short selling, such as price efficiency and liquidity, normally outweigh the disadvantages and proposed that there should be no direct restrictions on short selling.

III. Commission should consider the positive impact of other recent short sale restrictions before adopting a price test restriction that may result in unforeseen consequences

SIFMA notes that the Commission has already taken significant actions to address potential abuses related to short selling over the past year, with available data indicating that such actions have had numerous positive impacts. Among other things, the Commission adopted: (i) interim final temporary Rule 204T,[25] (ii) Rule 10b-21,[26] and (iii) Rule 10a-3T.[27]

Rule 204T bolsters the delivery obligations under Regulation SHO by (i) imposing a "hard delivery obligation" on all long and short sales of equity securities, so that such securities must be delivered by close of business on settlement date; (ii) requiring "immediate" close-out of open fail to deliver positions by borrowing or purchasing securities, as applicable, by no later than the beginning of regular trading hours on the day following settlement date of the fail with respect to short sales, and on the third settlement day after settlement for long sales; and (iii) imposing penalties for failure to timely close out open fail positions.

Rule 10b-21 targets (i) short sellers who deceive certain persons, such as their broker-dealers, about the source of borrowable shares in order to circumvent the Regulation SHO "locate" requirement; and (ii) long sellers who misrepresent to their broker-dealers that they own the shares being sold. Specifically, Rule 10b-21 would be violated if (1) a seller of a security deceives a broker-dealer, participant of a registered clearing agency, or purchaser regarding its intention or ability to deliver the security sold on the date delivery is due; (2) the seller fails to deliver the security sold; and (3) the seller acts with scienter.

Rule 10a-3T generally requires that every institutional investment manager that exercises investment discretion with respect to accounts holding "Section 13(f) securities" that has filed, or was required to file, a Form 13F for the calendar quarter, as required under Section 13(f) of the

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[24] Financial Services Authority, Discussion Paper 09/1 Short Selling, February 2009. Available at: http://www.fsa.gov.uk/pubs/discussion/dp09_01.pdf.

[25] Securities Exchange Act Release No. 58773 (October 14, 2008), 73 FR 61706 (October 17, 2008).

[26] Securities Exchange Act Release No. 57511 (March 17, 2008), 72 FR 15376 (March 21, 2008).

[27] Securities Exchange Act Release No. 58785 (October 15, 2008), 73 FR 61678 (October 17, 2008).

Exchange Act and Exchange Act Rule 13f-1(a) thereunder, file a report on Form SH with the Commission on the last business day of each calendar week immediately following a calendar week in which the investment manager has effected a reportable short sale with respect to a Section 13(f) security that is not an option. The investment manager is generally required to disclose all its short sales and short positions in Section 13(f) securities that exceed a de minimis amount.

While SIFMA's comment letters on these rules have recommended certain discrete modifications designed to rationalize the requirements and address potential unintended consequences, data from the Commission and other parties have shown that these regulatory actions have already been successful in drastically reducing the number of fails to deliver overall, as well as the number of securities appearing on the Regulation SHO Threshold Securities list. Among other things, OEA has released several studies, following the elimination of the options market maker exception in Rule 203 of Regulation SHO and the implementation of temporary Rule 204T, the most recent of which indicates that fails declined by 56.6% across all securities and 73.5% for Threshold Securities, and that the average daily number of Threshold Securities decreased by 77.5%, with those Threshold Securities with listed options decreasing by 82.1%.[28]

The United States Government Accountability Office ("GAO") also recently issued a report in May 2009 on Regulation SHO.[29] The GAO report reviewed regulatory actions taken by the Commission to address naked short selling and fails to deliver, including Regulation SHO, recent emergency orders, and temporary Rule 204T relating to delivery of equity securities. The GAO analyzed data from January 2005 through December 2008, and concluded that recent Commission actions have had a dramatic effect in greatly reducing fails to deliver. The GAO report also makes two recommendations to the Commission Chairman, both of which SIFMA supports. Specifically, the Chairman should (1) promptly finalize the draft revised 1994 Prime Broker Letter to address the current information gap in Regulation SHO for prime brokerage arrangements when temporary Rule 204T becomes final, and (2) develop a process that allows Commission Staff to raise and resolve implementation issues that arise from SEC regulations, including emergency orders and temporary rules, in a timely manner.

SIFMA believes that, by and large, concerns regarding short selling focus on abusive "naked" short selling, and that those concerns have now been adequately addressed by the above-referenced regulatory actions.[30] SIFMA also believes that, judging by some comments submitted to date in response to the Release, there may be a fundamental misunderstanding that re-instituting price test restrictions would be an additional means to address abusive "naked" short selling. This is simply not the case. SIFMA believes that, as an alternative to re-instituting price test restrictions, the Commission could facilitate investor confidence by (1) further

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28 OEA Study: "Impact of Recent SHO Rule Changes on Fails to Deliver," April 16, 2009. Available at: http://www.sec.gov/comments/s7-30-08/s73008-121.pdf.

29 GAO Report: "REGULATION SHO: Recent Actions Appear to Have Initially Reduced Failures to Deliver, but More Industry Guidance is Needed," GAO-09-483, May 2009. Available at: http://levin.senate.gov/newsroom/supporting/2009/report.GAO.060309.pdf.

30 In addition to the above-referenced economic studies showing the demonstrable effects of the recent actions, certain commenters also have observed that the actions have also addressed potentially abusive naked short selling. *See, e.g.*, Floyd Norris, *Goodbye to Naked Shorting*, NYT (May 1, 2009).

educating the public on issues relating to the market benefits resulting from short selling, perhaps through enhanced website disclosure and/or other outreach programs that focus on financial education, (2) highlighting the significant steps the Commission has already taken to address any potential abuses, including regulatory initiatives and enforcement actions, and (3) communicating clearly the fact that price test restrictions cannot reasonably be expected to achieve the same results and/or to address "naked" short selling concerns.

We note that, in this regard and following the effective date of Regulation SHO, the Commission Staff embarked on just such an investor education effort by publishing "Key Points Regarding Regulation SHO." The Commission Staff may want to consider, among other steps, extending these Key Points as well as undertaking other methods to clarify any misunderstandings regarding short sales and communicate the empirical findings provided by OEA and academics concerning short sales and short sale restraints.

SIFMA accordingly urges the Commission not to act based on little more than the hope that a positive outcome will result. Taking action based on the hope that it will boost investor confidence without it being supported by substantial facts and evidence could lead to unintended and negative consequences for our capital markets and all investors – large and small. In this regard, SIFMA notes that Commissioner Paredes expressed concern at the 2009 Open Meeting that efforts to facilitate investor confidence through price test restrictions could actually backfire, noting that *"the failure of a short sale restriction to serve its intended goals … actually might erode investor confidence over the long term, whatever the immediate positive impact might be."*[31] We urge the Commission therefore not to proceed without having clear objectives and certainty as to what it wants to achieve along with a reasonable basis to believe that the action it takes will achieve such purpose. Further, as emphasized by Chairman Schapiro in her opening remarks at the 2009 Open Meeting, the significant costs of price test regulation must be balanced against the potential benefits, including the value derived from the possibility that such action may simply boost investor confidence.[32]

IV. Proposed price test amendments

If the Commission, after conducting a thorough and meaningful review of available empirical data, determines that a short sale price test restriction is necessary to improve market quality and deter short selling abuses, then SIFMA firms request that market participants be provided with sufficient time to implement and test any of the proposed alternatives that the Commission decides to adopt, so as to avoid negatively impacting investors and the quality of the markets. Furthermore, SIFMA recommends that, in deciding on which alternative price test should be adopted, the Commission consider the fact that such price test must be capable of being implemented in a cost-efficient manner, and that such test should be structured to best achieve the goals set forth by the Commission. In this regard, SIFMA offers the following recommendations and information to assist the Commission in selecting such an alternative price test, should it determine one is warranted.

[31] Commissioner Troy A. Paredes, Statement Before the U.S. Securities and Exchange Commission Open Meeting on April 8, 2009. Available at: http://www.sec.gov/news/speech/2009/spch040809tap.htm.

[32] Chairman Mary L. Schapiro, Opening Statement Before the U.S. Securities and Exchange Commission Open Meeting on April 8, 2009. Available at: http://www.sec.gov/news/speech/2009/spch040809mls.htm.

A. SIFMA firms do not favor the proposed uptick rule

Echoing the Commission's concerns stated in the Release, SIFMA members in general feel strongly that a price test based on the last sale will not work in today's markets. Especially over the last few years, equity markets have changed and grown significantly, with the addition of multiple, disperse trading centers, as well as changes in how stock prices are reflected and disseminated. Regulation NMS has also required extensive systems development to, among other things, survey all the trading venues and available pricing data at any time. Re-imposing an uptick rule based on the last sale in this environment would entail developing infrastructure and technology capable of monitoring all the information rapidly coming from numerous sources. Such an undertaking would impose excessive implementation costs, and would also likely take significant time to be fully operational in order to be in compliance with such a price test.[33] Notably, none of the academics participating in the Roundtable favored the uptick rule, and, to SIFMA's knowledge, no empirical studies have recommended this approach.

B. SIFMA firms generally believe the circuit breaker approach is more favorable than a market-wide price test

Most SIFMA firms favor a price test that would be narrowly tailored toward certain stocks that have tripped a circuit breaker, while not also impacting other securities that are not subject to the circuit breaker. The implementation of a circuit breaker is likely to be an easier process than a market-wide price test, as the complexity of having to deal with prices and quotes coming from multiple venues will be avoided. The circuit breaker concept is also not original, with trading centers already having similar restrictions in place in the event of heightened market volatility and rapid declines in individual stock prices. However, while firms generally favor a circuit breaker over a market-wide price test, there remain certain open questions regarding the operation of a circuit breaker.

1. Benchmark for the circuit breaker trigger

The Commission has proposed that a circuit breaker would be triggered in the event that the price of a security declined by at least 10% from its prior day's closing price. As an initial matter, a number of firms recommend that the circuit breaker be based on a decline from a stock's opening price, as it is believed that this would be a more accurate barometer for a price decline. More specifically, using the opening price would discount any declines in an issuer's price from the prior day's close due to overnight news or other legitimate market events concerning the issuer. SIFMA further urges that the opening print be exempted from any of the proposed circuit breaker price tests. Other firms, however, recommend that the circuit breaker be based on a decline from the stock's closing price on the previous trading day, as it is believed

[33] We also note supporting statements made by Larry Leibowitz, Group Executive Vice President at NYSE Euronext, at the Commission's May 5, 2009 Roundtable, stating that the proposed uptick rule would be ineffective in today's market "due to improper price sequencing caused by permitted reporting delays and the potential for manipulation." Statement of Larry Leibowitz, NYSE Euronext, Group Executive Vice President and Head of Global Technology and U.S. Execution at SEC Roundtable on Short Selling (May 5, 2009). Available at: http://www.sec.gov/comments/4-581/4581-86.pdf.

this would be easier to implement from a policies and procedures approach. Regardless of whether a market close or open price is used, in the event a circuit breaker price test is implemented, SIFMA requests that the Commission clarify how it will determine the official price and the designation of where the price will come from. In this regard, SIFMA suggests that the Commission determine the price based off the primary listing venue or market of the particular security that triggers the circuit breaker price test.

In addition, many firms believe that, whether the decline is based off the prior day's closing price or opening price, a 10% decrease is not indicative of a price decline that might indicate abusive or abnormal trading activity and that should warrant additional price test restrictions. Rather, as discussed more fully below, firms believe that a 10% trigger is likely to restrict trading that is in fact normal for a large majority of the equity securities traded; therefore, the trigger should be based off of a higher percentage decline, such as 15% or 20%, which may be a more accurate indicator of the possibility of activity that might warrant trading restrictions. We note that a circuit breaker triggered off a 10% decline across-the-board trigger for all NMS stocks might be too aggressive and create serious limitations on the opportunity to trade and on available liquidity.

If the Commission is unwilling to have the circuit breaker be triggered by a decline of 20% for all NMS stocks that would be covered by the proposed rules, then SIFMA recommends that the Commission adopt a bifurcated approach to calculating the trigger, *e.g.*, that a higher percentage be incorporated for stocks that regularly trade at low prices (*i.e.*, using 15% or 20% as the threshold for stocks trading at $10 or less) or incorporating a set dollar decline that must be attained before the circuit breaker is triggered. Such a two-tiered approach would significantly reduce the number of triggered stocks in the under $10 category that would otherwise be triggered without any abnormal activity. In addition, we suggest that the Commission should monitor the impact of any threshold percentages adopted with respect to pricing and short selling activity, and modify such percentages as needed to facilitate market quality and liquidity. In this regard, we suggest the Commission undertake a study examining several percentage triggers (*i.e.*, 10%, 15% and 20%) and the effect such percentages will have on stocks, to determine whether and under what percentage scenarios a circuit breaker will be triggered and to establish the most efficient measures to take to minimize market disruption.

SIFMA notes that, in the universe of NMS stocks that would be affected under a price test, many stocks regularly trade at $10 or less. It would therefore be fairly easy and common for such securities to hit a 10% trigger at such price levels, as this would be within the normal daily price range of the stock. Indeed, a 10% price change in a low priced stock is often nothing more than small-lot orders executing off the quote (where the bid and offer could be 10% apart). More specifically, in approximate terms: there are almost 4,800 NMS common stocks – approximately 2,000 of which currently trade above $10 and 2,800 that trade below $10. Based on a member firm's review of trade data for this year so far, about 248 of these 4,800 stocks tripped the 10% threshold on average each day. Of the 248 total, 226 are in the under $10 category and 22 are in the above $10 category. The member firm calculated that, if a 20% trigger were applied to the stocks trading under $10, the total number of stocks that would trip the circuit breaker goes down to about 62 per day with 40 in the under $10 category and 22 in the over $10 category. The value in adding a second tier for stocks under $10 is that the markets will be able to provide additional liquidity when the stock is down marginally on the day, which generally translates into less volatility and more price stabilization.

Another member firm studied stocks in the Russell 3000 over a trading period from November 2008 through March 2009, and measured the average number of stocks per day, at price levels above and below $10, that declined by either 5%, 10% or 15% from the opening price. The study found for stocks trading above $10 that: (i) approximately 20% of the stocks declined by 5% from the open price; (ii) 3% of the stocks declined by 10%; and (iii) less than 1% of the stocks declined by 15%. For stocks trading below $10, the study found that: (i) approximately 46% of the stocks declined by 5% from the open price; (ii) 16.5% of the stocks declined by 10%; and (iii) 6% of the stocks declined by 15%.

Whatever the percentage threshold decline is determined to be, it is expected that the exchanges or securities information processors ("SIPs") would be responsible for calculating and disseminating the list of securities that have been triggered and are thus subject to a price test restriction.

2. Duration of the price test restriction after circuit breaker triggered

Opinions on the duration of the short sale price test restriction, after the circuit breaker has been triggered, are mixed. Certain member firms have conducted internal studies of price movements to identify securities that may experience an initial price decline of 10%, but then recover and result in a price decline below 10%. It should be noted that this appears to be a fairly common phenomenon. For example, a recent study by one member firm indicates that, over 60% of the time when an NMS stock declines by over 10%, it recovers to only decline by 9% or less before the end of the trading day.

Certain firms recommend that, in instances where this occurs, the price test restriction be removed (*i.e.*, a circuit breaker test should include some form of "on/off switch," whereby re-entering the market and short selling would be permitted once the price rises back above a trigger). Such firms believe that, without providing this option, liquidity and market quality could be negatively impacted.

Firms who favor this approach acknowledge that the programming effort that would be associated with such an "on/off switch" could be significant. Among other things, it is expected that the process to implement this option would require the exchanges to put a flag on any stock that hits the 10% threshold and then take it off when, and if, the stock price recovers. If a decrease of a full percentage point was required (*e.g.*, from 10% to 9%), however, it is believed that there would be relatively few instances where price test restrictions "flickered" on and off (*e.g.*, went from above 10% down to 9%, and then back up above 10%) during the day.

Certain firms feel strongly that such an "on/off switch" would allow firms to provide needed liquidity to stocks suffering through a period of high volatility, while also keeping in place the protections associated with a circuit breaker approach. Furthermore, it is believed that an "on/off switch" could dampen any possible "magnet effect" caused by investors who might otherwise feel pressed to execute their short sales quickly (for fear that a day-long restriction could soon be triggered). Knowing that a price test restriction imposed early in the day could, and often would, be reversed before the end of the day would likely result in investors taking a less aggressive approach to their short sales. This application could therefore go a long way towards softening volatility and stabilizing the price of stocks in decline.

3. Mixed views on an applicable price test restriction after circuit breaker is triggered

There are differing views among SIFMA member firms as to whether the circuit breaker should trigger a halt on short selling or a form of bid test. Some members prefer a circuit breaker followed by a short sale halt, as it would be the easiest and most cost-effective to implement, and would also be easier to comply with than a bid test, which could be subject to bid flickering. Other members favor a circuit breaker followed by a bid test, as it is believed that this approach could still facilitate legitimate short selling activities without raising the unintended consequences associated with a ban. No members surveyed favored a circuit breaker followed by a price test based on the last sale, which is in accordance with the firms' overall position mentioned earlier on using the last sale price for a price test.

With respect to the specific bid test that should be employed, certain firms believe that any bid test which is based on a sequence of bids, such as the proposed modified uptick rule, will raise significant compliance issues due to problems associated with bid flickering. These firms would recommend that the Commission adopt an approach similar to Regulation NMS, *i.e.*, look instead at the current bid. This approach is similar to that recommended by various exchanges prior to the Commission's issuance of the Release.[34] Certain firms note that a passive bid test, as was proposed by these exchanges, may be easier to implement and monitor than the bid test proposed by the Commission, as market centers would need to focus only on the current NBB, as opposed to the current and last differently priced NBB. Further, these firms note that a circuit breaker coupled with a bid test would limit instances where a security is the subject of severe downward pressure, thereby minimizing friction in terms of market liquidity and pricing efficiency, and would afford regulatory, compliance and supervisory resources under a policies and procedures approach and thus the ability to focus exclusively on, and to address, these situations.

Whichever version of a price test restriction is triggered by a circuit breaker, SIFMA firms feel strongly that certain exceptions would need to be adopted to ensure that the respective

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[34] On March 24, 2009, four major exchanges (Nasdaq, NYSE Euronext, BATS, and NSX) submitted a letter to Chairman Schapiro recommending the SEC propose a "Modified Uptick Rule," whereby short selling could only be initiated at a price ***above*** the highest prevailing national bid by posting a quote for a short sale order priced above the national bid. As such, the execution of a short sale would occur only at a higher price than the prevailing market at the time of initiation, and only on a passive basis (*i.e.*, short sales could not hit bids). These exchanges stated their belief that such an approach would be the most practical and effective way to structure adherence to a bid test and would be similar to oversight of the trade-through rule under Regulation NMS. The exchanges recommended that this approach be based on a policies and procedures requirement, and that brokers would have the responsibility for ensuring compliance with the rule before sending a short sale order into the marketplace.

test does not impact market quality and harm investors. Importantly, while the Release proposes an exception for bona fide market making activity from the circuit breaker halt rule, SIFMA believes it essential that such an exception also be provided in connection with the other price test proposals under consideration.

C. A "pilot" approach to re-instituting price test restrictions would not be feasible

Unlike the prior Pilot on the removal of price test restrictions, SIFMA does not recommend that any of the currently proposed price test restrictions be implemented through a similar pilot type program. Regardless of the approach the Commission might take, firms will still need to implement the technology and update their operational capacity to handle the specific limitations of a price test. We note though, in light of current market conditions and the unknown impact a price test could have on market quality, SIFMA does suggest that the Commission, should it determine a price test was necessary, consider the possibility of implementing a price test with a "sunset" provision. A sunset provision would allow for economic studies to be conducted to determine the impact of such a price test restriction on market conditions, and for "easier" removal of such a restriction should the Commission determine later that the restriction was not meeting the goals intended.

We also note that it can be argued that the restrictions imposed by the short sale emergency order instituting a ban on short selling worked as a type of "pilot" during September and October of last year. As noted above, certain economic studies of the short sale ban highlighted its unintended consequences, as well as the fact that it was generally believed not to have achieved its intended goals.

D. Policies and procedures approach preferable to prohibition approach

With respect to the implementation of any proposed rule, there remain questions of who will bear responsibility for conforming to the rules. Depending on the outcome of this issue, the opinions of SIFMA members may vary as to what is the most effective rule/restriction to implement; therefore, clarity is needed on this issue and on how either the policies and procedures or prohibition approach would work.

Some member firms have expressed support for having trading centers (as defined under Regulation NMS)[35] bear the responsibility of implementing and monitoring the proposed rules, and of preventing violations of any short selling restrictions. SIFMA firms believe that exchange-controlled SIPs should monitor prices and disseminate information flags when a security is in short sale mode and when it is free from short sale mode, and be responsible for rejecting various short sales unless they are appropriately marked "short exempt" on the incoming order.

Other firms have expressed support for a policies and procedures approach. As noted above, SIFMA members appreciate the difficulties they will face in implementing any proposed rule as a result of the speed at which today's markets move and prices are reflected. One relevant point with respect to a proposed bid test (or possible uptick test) is how the rule would

[35] Regulation NMS, Securities Exchange Act Rule 600(b)(78).

function together with how market information is disseminated to firms by various market vendors or trading centers. We believe that one way to ease restrictions related to the flow of data is to implement a policies and procedures approach with regard to short selling and trading on bids, as opposed to imposing on firms the burden of having to rely on the actual bid sequence. This preferred approach could be implemented through a policies and procedures approach similar to that under the current Regulation NMS regime.

V. Essential exceptions from any price test restriction

If the Commission should decide a price test is needed and would help to foster stability and order in the markets, we acknowledge the difficult task the Commission faces in formulating a meaningful and workable rule that does not also result in unintended negative consequences. In this regard, should the Commission ultimately decide to adopt one (or a combination) of its proposed amendments, SIFMA believes that the exceptions proposed by the Commission in the Release fall short of ensuring that market participants will be able to, among other things, provide stability and liquidity to the market.

Consequently, we believe that broader exceptions for specific trading activities need to be included under any proposed price test, including for many market participants who implement short selling trading strategies as a means to facilitate market liquidity and who play a positive role in ensuring efficiency in the markets. The discussion below sets forth our views on certain exceptions that are deemed to be essential.

In addition, we have included in Appendix A a list of other exceptions, as well as comments on the exceptions proposed by the Commission in the Release.

A. Exceptions for bona fide market making in NMS stocks and derivatives on stocks

As set forth in the Release, the Commission has not proposed an exception for market makers engaged in bona fide market making from all of the short sale price test alternatives. Rather, the Commission has offered a limited exception from the proposed circuit breaker halt rule for short sales by market makers engaged in bona fide market making in NMS stocks, as well as in derivatives on NMS stocks. SIFMA members strongly support the need to add an exception to all other price test proposals for this activity (thus, including under any modified uptick rule based on a best bid, whether or not triggered by a circuit breaker). SIFMA members believe that this exception is critical for allowing firms to implement trading strategies that provide necessary liquidity to the market and serve as an important component of orderly markets.

SIFMA notes that the Commission's decision to not incorporate a market maker exception from all the price test alternatives is inconsistent with other recent actions on short selling. More specifically, the Commission provided exemptions for market makers from the prior emergency orders issued in the summer and fall of 2008. The Commission exempted bona fide market makers from the borrow and arrangement-to-borrow requirements of the Commission's July 2008 emergency order regarding the securities of certain financial companies "to permit market makers to facilitate customer orders in a fast-moving market without possible delays associated with complying with the borrow and arrangement-to-borrow requirement of the Order."[36] In addition, the Commission exempted market makers from the September 2008 emergency order banning short sales in the securities of certain financial firms "to permit market makers to continue to provide liquidity to the markets."[37] The Commission has not provided any justification for why it believed exceptions for market makers were necessary and appropriate in those contexts, but not here.

The effect on liquidity from short sale restrictions on market maker quotes was evidenced, for example, during the period in September 2008 when options market makers were subject to new restrictions pursuant to the Emergency Order on short sales in financial stocks. A comparison of quoted option spreads on banned stocks versus other stocks during the days surrounding the release of the September 2008 emergency order suggests that the restrictions had a material effect on the width and depth of option quotes.[38] Options market makers report that short sale restrictions are important factors in the amount of liquidity an options market maker is willing to commit, particularly because such restrictions create risks that translate into less liquidity and, ultimately, more volatility in the options and the underlying stocks.

Moreover, SIFMA notes that Regulation SHO otherwise incorporates an exception from the "locate" requirement for "short sales by market makers engaged in bona fide market making activities." Indeed, given all the attention that the Commission has paid to "naked" short selling, including distinguishing it from other types of valid short selling, SIFMA believes it would be incongruous to provide an exception from the locate requirement for short sales in connection with bona-fide market making, but not from all of the proposed price tests. We recommend that the exception for market making in NMS stocks be modeled on the current exception from the locate requirement, including such exception's reliance on the definition of "market maker" in Section 3(a)(38) of the Exchange Act. SIFMA requests that the Commission similarly incorporate such an exception for any proposed price test, including for the short selling activities of (i) market makers on exchanges and in the over-the-counter stock and derivatives markets; (ii) market makers in options; (iii) market makers in Exchange Traded Funds ("ETFs"); (iv) block positioners in common stock, ETFs and options; and (v) market makers in convertibles and warrants.

SIFMA also believes it important to include an additional exception to encompass trading activities related to, among other things, OTC derivatives, structured notes, and listed derivatives. A similar exception was provided by the Commission when it banned short selling in select financial stocks in September and October 2008 (the "Short Sale Ban").[39] We suggest that the Commission incorporate a flexible definition of market makers to cover those entities that may be the counterparty on derivative transactions – not only registered broker-dealers but also banks and other liquidity providers as well – and therefore have a need to effect short sales to hedge long exposure. However, we also acknowledge that an exception that is too broad

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[36] Securities Exchange Act Release No. 58190 (July 18, 2008), 73 FR 42837 (July 23, 2008).

[37] Securities Exchange Act Release No. 58611 (September 21, 2008), 73 FR 55556 (September 25, 2008).

[38] Battalio and Schultz, University of Notre Dame, Working study of 2009 on "Option Quote Changes and the Emergency Orders."

[39] Securities Exchange Act Release No. 58592 (September 18, 2008), 73 FR 55169 (September 24, 2008) (the "Short Sale Ban").

could be subject to abuse. Therefore, we recommend that the proposed exception be limited to situations where market makers effecting such hedging short sales for new trades (or, if there is a circuit breaker approach enacted, those trades occurring while the circuit breaker is in effect) do not know that the customer/counterparty on the other side of the derivative transaction is establishing or increasing an overall net short position, measured on a delta equivalent basis. We believe such language would prevent "net shorting" by market participants in a chain of transactions in which there is no "long" holder of the underlying security. SIFMA believes, however, that the market maker should not be required to obtain representations from its customer/counterparty or conduct any affirmative inquiry regarding the customer/counterparty's positions. Firms note that it will not be feasible to obtain a representation from a counterparty for existing trades and therefore, without an exception, firms would have to cease their hedging activities, possibly leading to the early termination of various derivative trades. Therefore, market makers should also be able to dynamically adjust pre-existing hedge positions with additional short sales, regardless of the net "long" or "short" position of their counterparties.

SIFMA proposes the following possible language for such an exception to cover:

> *short sales effected as part of bona fide hedging by any market maker holding a corresponding "long" position, either in the form of (i) the underlying security, (ii) a derivative contract on the underlying security or (iii) a convertible or mandatory security that is convertible into the underlying security or which gives the holder exposure to the upside and/or downside price movement of the underlying security, provided that in the case of (ii) and (iii), for new trades only (not for existing trades), the person relying on the exception does not know that its counterparty to the derivative contract or the issuer of the convertible or mandatorily convertible security is establishing or increasing an overall net short position in the underlying security (and, if the long position of the counterparty or convertible/mandatory issuer is itself in the form of a derivative contract, such counterparty or convertible/mandatory issuer does not know that its counterparty to the derivative contract is establishing or increasing an overall net short position in the underlying security).*

B. Incorporate exceptions from, or necessary to comply with, Regulation NMS

SIFMA believes that any price test restrictions must be able to function in parallel with other regulatory schemes. In particular, we believe that price test restrictions, in order to be effective in today's markets, must be able to work in conjunction with Regulation NMS.[40] SIFMA acknowledges that Regulation NMS was implemented and designed to strengthen and modernize the regulatory structure of U.S. markets by regulating how individual trading centers interact with the rest of the market when routing orders or displaying quotations. Whatever proposed price test is ultimately implemented will need to take into consideration certain order and quotation regimes of trading centers, and particularly as now governed by Regulation NMS. Consequently, we believe it is vital that many if not all of the same exceptions and exemptions

[40] See Securities Exchange Act Release No. 51808 (June 9, 2005), 70 FR 37496 (June 29, 2005).

functioning under Regulation NMS be provided under any price test restriction. This would include the exceptions listed under Rule 611(b) of Regulation NMS,[41] relating to trade-throughs of protected quotations and trades executed at a benchmark price. In addition, the Commission has provided commentary and FAQs explaining and expanding the exceptions under Regulation NMS,[42] as well as certain SEC No-Action Letters, which should also be incorporated as exceptions from a price test.[43]

In addition to the general exceptions that have been included under Rule 611(b) of Regulation NMS and issued under various No-Action Letters, SIFMA believes that the Commission will need to address specific issues related to intermarket sweep orders ("ISOs") and after-hours trading. With respect to ISOs, SIFMA notes that, while the Commission had previously provided an exception from prior Rule 10a-1, the Commission has not incorporated this as an exception from the proposed price test restrictions. More specifically, the prior exception from Rule 10a-1, as set forth in the Regulation NMS FAQs, allowed a "broker-dealer routing ISOs solely to facilitate its executions of a customer's long sale in compliance with Rule 611, to mark the ISOs as 'short exempt' to allow destination trading centers to execute the orders against better-priced protected quotations without regard to tick restrictions of Rule 10a-1." SIFMA notes the possibility that the absence of discussion on this ISO exception in the Release may have been an oversight, rather than intentional. In any event, SIFMA believes such an exception to be essential, as otherwise it would be practically impossible to comply consistently with both the Regulation NMS requirements governing ISOs and a price test restriction.

In addition to the exceptions stated above, other aspects of the Regulation NMS regulatory scheme should apply to any price test. In particular, the Release proposed applying short selling restrictions during regular trading hours; however, we believe there is a greater need for clarifying the parameters and duration under which price test restrictions would apply and how markets would be affected in after hours trading. In this respect, we suggest that any price test restriction and the requisite exceptions should be defined and limited to "trading hours" as defined in Rule 600(b)(64) of Regulation NMS.

Finally, we note that preferred securities are exempt from Regulation NMS. We therefore presume that these types of securities would similarly be excluded from any proposed price test restrictions.

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[41] 17 C.F.R §242.611.

[42] "Responses to FAQs concerning Rule 611 and Rule 610 of Regulation NMS," April 4, 2008. Available at: http://www.sec.gov/divisions/marketreg/nmsfaq610-11.htm.

[43] See: Order Granting an Exemption for Qualified Contingent Trades from Rule 611(a) of Regulation NMS (Securities Exchange Act Release No. 54389, August 31, 2006); Order Exempting Certain Sub-Penny Trade-Throughs from Rule 611 of Regulation NMS (Securities Exchange Act Release No. 54678, October 31, 2006); Order Exempting Certain Print Protection Transactions from Rule 611 of Regulation (Securities Exchange Act Release No. 55883, June 8, 2007); Order Exempting Certain Error Correction Transactions from Rule 611 of Regulation NMS (Securities Exchange Act Release No. 55884, June 8, 2007); Order Modifying the Exemption for Qualified Contingent Trades from Rule 611(a) of Regulation NMS (Securities Exchange Act Release No. 57620, April 4, 2008); Order Exempting Non-Convertible Preferred Securities from Rule 611(a) of Regulation NMS (Securities Exchange Act Release No. 57621, April 2, 2008). All available at: http://www.sec.gov/spotlight/regnms.htm.

C. Exception for issuer and selling shareholder transactions

SIFMA notes that the Commission has proposed an exception from price test restrictions for certain syndicate activity. SIFMA members support the need for this exception. Additionally, SIFMA feels strongly that such exception should be clarified to make clear that it covers short sales effected by underwriters and their affiliates in connection with distributions on behalf of issuers and selling shareholders. This would enable the type of capital raising activity and hedging transactions recognized under the "Goldman II" interpretive letter issued by the Office of Chief Counsel of the Division of Corporate Finance[44] as well as "stock borrow facilities" established by issuers or selling shareholders in connection with offerings of convertible or exchangeable securities by the issuer. Secondary public offerings are typically priced below prevailing market prices, thereby necessitating the requested relief. SIFMA further notes that such sales by nature are not abusive, and should be viewed as outside of the scope of concerns that short sale regulation is intended to address.

D. Exception for hedging in connection with the purchase of convertible bonds and similar instruments

SIFMA believes that, in order to facilitate capital raising through the use of convertible bonds and other similar instruments (such as convertible preferreds and mandatory convertibles), there needs to be an exception from any price test to allow investors purchasing a convertible instrument to hedge their long exposure. SIFMA notes that the absence of such an exception from the Short Sale Ban significantly undermined the ability of issuers to raise capital during the pendency of the Ban, at a point in time when access to capital was especially important for many of these issuers. Moreover, SIFMA notes that, in other situations, the Commission has recognized the need to provide exceptions from short sale restrictions to allow an investor to hedge their long exposure associated with purchasing in an offering of convertibles. This includes Rule 105 of Regulation M, where the Commission clarified that only short sales effected during the Rule 105 "restricted period" in the securities that are the subject of an offering would generally prohibit purchasing in the offering, and that short sales in other related securities (*e.g.*, shorting the common stock in advance of an offering of convertibles) would not also restrict purchasing in an offering.[45]

E. Exception for short sales in exchange traded funds, bona-fide hedges of index-linked products

SIFMA believes that short sales conducted in index-linked products do not raise the concerns regarding abusive short selling that the Commission's proposed short sale restrictions are intended to address. The Commission has recognized this fact in providing no-action relief for ETFs and portfolio depository receipts (PDRs) from former Rule 10a-1, noting that the "composite and derivative" nature of such instruments made it unlikely that short sales in these instruments would lead to the abuses that Rule 10a-1 was intended to address, and further noting that such rule did not apply to "analogous derivative products such as index options and index

[44] Goldman, Sachs & Co.; SEC No-Action Letter, (October 9, 2003). Available at: http://www.sec.gov/divisions/corpfin/cf-noaction/goldmansachs100903.htm.

[45] Securities Exchange Act Release No. 56206 (August 9, 2007), 72 FR 45094 (August 10, 2007).

futures products."[46] Accordingly, SIFMA believes that shorting activity in index-linked instruments should not be subject to any of the Commission's proposed price test restrictions, so long as such instruments are consistent with the conditions set out in the ETF No-Action Letter.[47]

SIFMA firms do not believe that the Commission has provided sufficient evidence as to why the concerns warranting the prior relief for ETFs would not be equally applicable with respect to the proposed price test restrictions.

In addition, indexed financial instruments – such as ETFs – provide investors, including retail investors, with an efficient and liquid manner of achieving their investment objectives by providing for weighted market participation and capital protection. The issuers of these index-based instruments generally hedge their exposure through short sales of the underlying securities of the index. In those instances where the components of the indexed instrument constitute a small portion of the overall index, it is highly unlikely that any short sales used to effect a hedge could be used in an abusive manner. Accordingly, SIFMA would advocate that no short sale restrictions should apply to issuers of indexed instruments (regardless of whether they are a market maker in such instruments) in those instances where such issuer effects a short sale in a security for purposes of hedging their exposure to such instrument, and such security constitutes no more than 5% of the indexed instrument.

Absent this exception and if even a single security underlying an indexed instrument becomes subject to a short sale restriction (as may be the case under a "circuit breaker" approach), issuers of these instruments will be prevented from effectively hedging the indexed instrument. In other words, a short sale restriction intended to apply to a single security will effectively prevent short sales in all of the other securities that constitute the indexed instrument. This inapposite result creates an overly-broad short sale restriction which unnecessarily prevents issuers of indexed instruments from accommodating their customers' investment objectives, while doing nothing to advance the Commission's goal of preventing abusive short selling.

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[46] See no-action letter to Claire P. McGrath, Esq., Vice President and Special Counsel, The American Stock Exchange, from James Brigagliano, Assistant Director, Division of Market Regulation, dated August 17, 2001 (the "ETF No-Action Letter"), p5.

[47] In order to be subject to the relief set out in the ETF No-Action Letter, ETFs and PDRs generally needed to meet the following conditions: (1) Fund Shares needed to be issued by an open-end management investment company or a unit investment trust, registered under the Investment Company Act of 1940; (2) ETFs needed to consist of a "basket" of twenty (20) or more different component stocks, in which no one stock could constitute more than 25% of the total value of the ETF; (3) At least 85% of the ETF had to be comprised of component stocks that have a minimum public float value of at least $150 million and a minimum average daily trading volume (ADTV) of at least $1 million during each of the previous two (2) months of trading prior to formation of the relevant ETF; provided, however, if the ETF has 200 or more Component Stocks, then 75% of the Component Stocks had to meet the $150 million public float and the $1 million ADTV thresholds; (4) Each component stock had to be listed on a national securities exchange or the Nasdaq Stock Market, including the Nasdaq SmallCap Market; and (5) ETFs had to be issued or redeemed in Creation Unit aggregations of 50,000 shares or more. The value of each Creation Unit had to be at least $1 million at the time of issuance, and had to be passively managed and track a particular index whose components were publicly available. The intra-day proxy value of the ETF and the value of the "benchmark" index had to be publicly disseminated throughout the trading day. ETF No-Action Letter, pgs. 2-3.

VI. Implementation, Costs and Timing

SIFMA believes that the Commission should provide sufficient time for firms and trading centers to implement and update technology in conformity with any proposed rule. It is our view that the three-month implementation period proposed by the Commission is not adequate, and instead propose a minimum period of twelve months after approval to allow for programming and testing of systems. We note that, in the Pilot Study, the implementation of that program was also delayed by a number of months due to the difficulty in updating the necessary technology. The Commission should therefore understand that it will not be a simple and easy process to update all the software, including outside vendor software used by many firms; therefore, full compliance will likely not be accomplished in the time frame proposed in the Release.

Further, SIFMA believes that the Commission should take into consideration the internal costs that would be associated with implementing any rule, including those related to legal and compliance issues and annual ongoing costs to surveil the policies and procedures that would need to be implemented to adhere to the price test and to respond to regulatory inquiries and examinations regarding firms' compliance with the rule. Costs borne by firms – both the costs for implementation and on-going – would likely trickle down to the investor in terms of additional barriers to entry into the U.S. equity markets.

SIFMA has conducted an internal survey of member firms to determine the costs that would be incurred and the approximate time frame required for implementing and becoming fully compliant with any of the proposed price tests, and with ongoing surveillance and monitoring demands for each of them. These estimates are discussed in Appendix B below. Our survey has indicated that it will take close to twelve months and, in some cases, even longer to have technology and operations up and running in order to properly handle compliance. This time frame is independent of whether a rule would be implemented on a policies and procedures basis or under a prohibition approach. We therefore believe that the Commission should grant more time than three months for firms to implement and test technology before any price test becomes effective.

In addition, similar to the difficulties firms experienced in programming their systems for compliance with Regulation NMS, there are many outstanding questions and complexities in programming that will need to be resolved. We note that, for certain price tests, implementation of the necessary technology may prove to be an easier process than for other proposed price tests, and time frames will differ depending on the chosen course. However, to determine the real burdens related to this issue, we believe that the Commission must provide greater clarification on the parameters of the proposed tests and provide assurance that implementation will be consistent across exchanges and trading centers.

VII. SIFMA is strongly opposed to any pre-borrow requirement on short sales

Some commenters, as well as members of Congress, have recently suggested that the Commission adopt a requirement that, prior to effecting short sales, shares must actually be pre-borrowed, as opposed to the current "locate" requirement of Regulation SHO, whereby the short seller is required to have "reasonable grounds to believe that the securities sold short can be borrowed for delivery on settlement date." SIFMA members are strongly opposed to any type of pre-borrow requirement, as there could be severe unintended consequences resulting from such a requirement.

SIFMA firms generally believe that the pre-borrow requirement imposed by the July Emergency Order resulted in a number of unintended consequences which, ultimately, had a detrimental impact on the market in excess of the perceived benefits derived from such a requirement. Surveys that SIFMA conducted of member firms after the July Emergency Order showed that the observed impacts included: (i) a significant reduction in stock loan liquidity in some of the subject securities; (ii) significantly higher borrowing costs; and (iii) substantial balance sheet costs for many firms related to financing pre-borrows, which ultimately impacted such firms' efficient use of capital. Moreover, the July Emergency Order caused a fundamental shift in securities lending operations, *i.e.*, firms were forced to convert from borrowing stock on settlement date as necessary to meet net settlement obligations to borrowing or arranging to borrow securities even before short sales were executed on trade date. As the Commission is aware, although Regulation SHO requires a "locate" to be obtained prior to a short sale being effected, many locates do not result in actual borrowing on settlement date, due to, among other reasons, the potential seller ultimately deciding not to effect the short sale transaction, or the securities otherwise being bought back the same day to cover the short sale, thus netting out a firm's delivery obligations in the continuous net settlement system ("CNS").[48] SIFMA notes that many of these observations by member firms are substantiated by several studies that have focused on the impacts of the July Emergency Order, including a study by OEA,[49] each of which generally concluded that the pre-borrow requirement had the effect of reducing liquidity and increasing borrowing costs.[50]

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48 As the Commission knows, the vast majority of clearance and settlement of securities transactions occurs through the CNS system, operated through the National Securities Clearing Corporation ("NSCC"), a "clearing agency" that is registered with, and subject to oversight by, the SEC. In short, CNS is an automated book-entry accounting system that centralizes the settlement of compared security transactions and maintains an orderly flow of security and money balances. More specifically, CNS essentially nets all settling purchase and sale transactions (long and short) in particular securities effected by a "clearing firm participant." These transactions are netted against each other and netted against the prior day's closing positions (if any) to compute the participant broker-dealer's net settlement commitment (CNS position) each day. To effect settlement of a participant broker-dealer's CNS delivery obligation, existing securities positions are transferred from such participant's account at the Depository Trust Company ("DTC") to NSCC's account to cover the participant broker-dealer's delivery obligation to CNS.

49 OEA Study: "Analysis of the July Emergency Order Requiring a Pre-Borrow on Short Sales," January 14, 2009. Available at: http://www.sec.gov/spotlight/shortsales/oeamemo011409.pdf. The study found that "imposing a pre-borrow requirement may have had the intended effect of reducing fails but may have resulted in significant costs on all short sellers even those whose actions were not related to fails." Specifically, it was found that stocks subject to the July Emergency Order experienced large and statistically significant decreases in short selling volume. The study concluded that a pre-borrow requirement placed on smaller, more liquid and hard-to-borrow stocks might cause a significant disruption to short selling and liquidity, and that one effect of the July Emergency Order may have been to increase the cost of borrowing. Further, it was noted that "the cost of borrowing may increase, for example, if short sellers borrowed for longer periods of time, or brokers proactively borrowed shares in anticipation of future short sellers." SIFMA notes that the GAO Report also stated that: "Trading and Markets staff also told us that the costs of a market-wide pre-borrow requirement to address Fails to Deliver, manipulative naked short selling, or market manipulation occurring within the T+4 time frame might outweigh any potential benefits, especially considering that the vast majority of trades settle on time."

50 *See also* Bris, "Short Selling Activity in Financial Stocks and the SEC July 15th Emergency Order," August

Additionally, it is also the view of SIFMA member firms that the institution of a pre-borrow requirement would have the effect of impacting all short sale activity on an indiscriminate basis, thus hindering liquidity and raising borrowing costs in connection with otherwise legitimate short sale activity which, as we have previously noted, provides many benefits to the market. Ultimately, we believe there are more appropriate, and more effective, methods through which to address potentially abusive short-sale activity; most notable among them is Rule 204T, which has already had a significant impact on reducing fails to deliver in the market. SIFMA also notes that the negative impact of a pre-borrow requirement may be significantly worse for small and mid-size firms that do not have internal or affiliated stock lending facilities.

Accordingly, SIFMA urges the Commission to consider the foregoing in connection with any contemplation of a potential pre-borrow requirement and, additionally, would respectfully request that, should the Commission consider proposing any such requirement, that SIFMA member firms first be given an audience with the Commission to discuss in more detail its concerns with any such proposal.

VIII. Conclusion

SIFMA shares the concerns of all investors and markets participants regarding periods of extreme volatility in the securities markets, and appreciates the difficult task of the Commission in understanding the causes of such extraordinary events and in continuing to seek ways to address such volatility and to restore investor confidence.

We believe that any price test is certain to have negative impacts on the liquidity and price discovery functions of the securities markets, and therefore should only be adopted if supported by economic analysis and if the benefits associated with the restrictions outweigh the associated costs. As such, we believe it is paramount that the Commission continues to engage in a deliberate and thorough process to determine the best course of action in this regard, a process that includes commissioning and/or otherwise taking into account additional economic studies and empirical data evidencing whether there is a need for a new regulatory scheme. And, should the Commission determine, in light of the myriad and complex nature of the issues at hand, that any price test proposal it may be considering should be subject to further notice and comment, then SIFMA would be happy to provide further comments at that time.

In closing and to the extent the Commission determines a price test to be necessary, SIFMA stands ready to assist the Commission in determining the most workable and effective rule. As noted above, we believe it is vital that, for any such price test, the Commission incorporate certain exceptions to allow it to work in tandem with Regulation NMS, to provide

2008. This study tracked the performance of the 19 financial stocks covered by the July Emergency Order against a matching sample of comparable financial stocks. The study found that the negative returns and lower market quality of the 19 financial stocks cannot be attributed to short selling activities. In specifically addressing the impact of the July Emergency Order, the study found that the 19 financial stocks suffered a significant reduction in intra-day return volatility and an increase in spreads, suggesting a deterioration of market quality. Further, the report concluded that, as a result of the July Emergency Order, overall market efficiency declined after the order became effective.

market makers with the ability to continue their vital role in providing liquidity and quality to the market, and to further other important market impact goals. We also urge the Commission to consider that any rule and its limitations should be implemented in a uniform manner, providing clarity to all market participants. Lastly, the Commission must balance the potential yet unknown benefits against the certain costs that price restrictions will incur.

If you have any questions or require additional information, please do not hesitate to contact the undersigned or Ann Vlcek, SIFMA Managing Director and Associate General Counsel, at 202-962-7300. Thank you for your attention to this request.

Sincerely,

Ira D. Hammerman
SIFMA Senior Managing Director and
General Counsel

cc: The Hon. Mary Schapiro, Chairman
The Hon. Kathleen Casey, Commissioner
The Hon. Troy Paredes, Commissioner
The Hon. Elisse Walter, Commissioner
The Hon. Luis Aguilar, Commissioner
James A. Brigagliano, Co-Acting Director, Division of Trading and Markets
Daniel Gallagher, Co-Acting Director, Division of Trading and Markets
Josephine Tao, Assistant Director, Division of Trading and Markets
Victoria Crane, Branch Chief, Division of Trading and Markets
Kevin J. Campion, Sidley Austin LLP
Arik Hirschfeld, Sidley Austin LLP

APPENDIX A: Additional Exceptions and Related Comments

In addition to those exceptions described in the body of our comment letter, SIFMA members believe that the following exceptions, some of which were proposed in the Release, are necessary to maintain stable and effective markets. In some instances, we have requested that the exceptions proposed in the Release be expanded and made applicable under additional proposed price tests. We also believe that, in many instances, clarification is needed as to the scope of the proposed exception and the related activities covered thereunder.

Title of Exception	Comments / Recommendations
Broker-Dealer Provision	SIFMA members agree with the need for this exception.
Seller's Delay in Delivery	SIFMA members agree with the need for this exception, but suggest the exception be aligned with the Regulation SHO locate requirement and delivery within 35 days. In addition, the Commission should clarify that the exception covers 144 sales, others sales pursuant to a prospectus, and cashless exercises of stock options. We note that this exception may also be related to the Owned Securities exception under the proposed circuit breaker halt rule, but again we seek clarification on the parameters.
Odd Lot Transactions	SIFMA members agree with the need for this exception.
Domestic Arbitrage	SIFMA members strongly believe that this exception needs to be expanded to cover more trading scenarios, such as convertible arbitrage strategies. We suggest that the exception should be tied to capital/issuer raising transactions and note, in this regard, the negative effect that the Short Sale Ban had on convertible arbitrage strategies and capital raising activities.
International Arbitrage	SIFMA notes that the language of this exception is limited to "good faith accounts." We ask the Commission to clarify the meaning of this term and whether proprietary trading accounts are included under this exception or whether the term relates to margin accounts or some other type of customer account.
Over-Allotments/Lay-Off Sales	SIFMA members support the need for this exception, but recommend extending it to cover other sales effected in connection with a distribution or issuer transaction, such as registered short programs. We request clarification on whether this would be covered under the exception. Further, we suggest the exception be raised in terms of registered transactions as opposed to "issuer" transactions and that, in connection with this exception, transactions with issuers that are not registered should also be exempt.
Riskless Principal Transactions	SIFMA agrees with the need for this exception. However, we also see an important need for a broader market-making related exception, as described in the body of our comment letter.
Transactions on VWAP	SIFMA believes there needs to be clarity on the definition, calculation and parameters of VWAP transactions, such as whether the calculation

	is based on a full day time frame or some other measurement. Further, we believe there is a need to expand this exemption to cover benchmark exceptions, similar to the exceptions under Regulation NMS. We would also like to see the exception expanded to encompass short sales of individual stocks comprising a broad-based index or basket as a bona fide hedge of a structured product linked to such index or basket (whether executed at the VWAP or otherwise), so long as no one stock constitutes more than 5% of a basket consisting of 20 or more stocks. In this respect, and as noted above, we urge the Commission to include a broad exception incorporating Regulation NMS-related issues and baskets.
Error in Marking a Sale Short; Electronic Trading Systems	SIFMA members agree with the need for these exceptions. We note that a number of exceptions have only been proposed for the uptick rule, but would not be applicable in the event a modified uptick (bid test) rule is implemented. We believe that these exceptions should be expanded to cover errors under the modified bid test, should this proposed test be implemented. Therefore, we suggest that the proposed exceptions should also be applicable under the (i) proposed modified uptick rule and (ii) proposed circuit breaker modified uptick rule.
Trade-Throughs	SIFMA members urge the Commission to include this exception under the proposed modified uptick rule (bid test) in response to scenarios for locking/crossing markets before taking out the bid. We note that such an exception would be necessary under the Regulation NMS scheme dealing with this scenario. We suggest the Commission could incorporate the 2003 proposed language for locked/crossed markets. As noted above under the section dealing with proposed Regulation NMS exceptions, we understand that an exception covering ISOs may also relate to this issue. Further, in complying with Regulation NMS, we believe that the proposed exception should also be applicable under the (i) proposed modified uptick rule and (ii) proposed circuit breaker modified uptick rule.
Facilitation of Customer Buy Orders	SIFMA members request that this exception be extended to allow market makers and other liquidity providers to sell short at the bid, without violating the proposed bid test. As noted above, SIFMA members request the Commission to provide a broader exception for market makers engaged in bona-fide market making activity.
Exchange for Physicals ("EFPs")	SIFMA members note that not being able to perform an EFP transaction may limit the liquidity available in the listed futures markets. Therefore, we suggest an exception for trading in these products.
Baskets/Re-Weighting of Baskets	SIFMA members request an exception that allows for short sales with respect to hedging a basket, as large and diverse baskets prevent the possibility of short sales having a manipulative effect.
Index Expirations	SIFMA members note there is a need for an exception for trading in OTC products linked to indices, whereby the expiration of an index may cause a need to effect short sales. We therefore request that the Commission consider an exception for this activity.

Options and Futures Contract Expiration; Assignment to Call Writers Upon Exercise of an Option	SIFMA notes that these exceptions have only been proposed in connection with a circuit breaker triggering a halt in short selling. We believe these are important exceptions for the facilitation of orderly and liquid markets and request that they be applied to the modified uptick rule, whether as a market-wide test or in connection with a circuit breaker. Therefore, we request that these proposed exceptions should also be applicable under (i) the proposed modified uptick rule and (ii) proposed circuit breaker modified uptick rule.
Market on Close ("MOC") Orders	SIFMA members believe there will be many more market disruption events if short sales cannot be done via MOC orders, especially for basket and index trades. Therefore, we request the Commission consider an exception for this type of trading activity.

APPENDIX B: SIFMA Survey of Member Firms: Cost and Time Estimates for Implementing the Commission's Short Sale Price Test Proposals

SIFMA conducted a survey of its member firms to secure their estimates for the time (the time needed to research and determine what needed to be done, and then to program and test systems changes) and the costs (for the legal, business and operations/technology staffs and systems that would be involved) associated with implementing each of the five proposals, as well as the costs associated with on-going surveillance of and compliance with the proposals should one be adopted. SIFMA received responses from some 50 firms of all sizes and business models. The estimates below reflect the responses received from most of these firms, and should be viewed as just a "rough" idea of the time needed and costs involved with implementing these proposals. We note that there are many variables to consider in producing accurate estimates; for example, many of the parameters of the different proposals still need to be finalized, including whether exchanges and/or vendors in some instances will be responsible for most of the work involved, and it is unclear what kind of industry-wide testing (and "fine-tuning") period will be needed once programming has taken place (which could add on at least a couple months in additional implementation time). We also note that some estimates below that are on the low end may reflect the fact that those firms do in fact use outside vendors, which will be responsible for implementing most of the programming changes and not the firms that use them. We hope that these overall estimates are helpful to the Commission in analyzing the costs and benefits of each proposal, and are happy to provide more details on these estimates should the Commission Staff find that useful.

1. Market-Wide Price Test – Modified Uptick Rule Based on National Best Bid

a. Larger firms' (bulge bracket) cost estimates for implementing this proposal were generally around $1 million, but also ranged as high as $7 million for some firms. Many of the estimates for implementation time were around 8 months, but some estimates ranged up to 12 months. On-going monitoring costs were estimated to be generally around $100,000, but ranged as high as $1.5 million for some firms.
b. Regional firms estimated generally around $200,000 for their implementation costs, but some estimates ranged as high as $500,000. Their estimates for implementation time generally were around 6 months, but ranged up to 18 months for some firms. On-going monitoring costs were generally around $50,000, but ranged as high as $450,000.
c. Clearing firms provided estimates generally around $1.1 million for their implementation costs, with a high up to about $1.9 million. Their estimates for implementation time ranged from 7 - 18 months, with most estimates around 13 months. On-going monitoring costs were generally estimated to be around $175,000, but ranged up to a high of $250,000 for some firms.

2. Market-Wide Price Test – Uptick Rule Based on Last Sale Price

a. Larger firms' cost estimates for implementing this proposal were generally around $1.1 million, but also ranged up to $8 million for some firms. Their estimates for implementation time were generally around 8 months, but ranged up to 15 months for some firms. On-going monitoring costs were generally around $100,000, but ranged up to $1.5 million for some firms.

b. Regional firms generally estimated around $200,000 for their implementation costs, but some firms estimated up to $500,000. Their estimates for implementation time generally were around 6 months, but ranged up to 18 months for some firms. On-going monitoring costs were estimated generally around $50,000, but with a range up to $450,000.

c. Clearing firms provided estimates generally around $1.1 million for their implementation costs, but up to a high of about $1.8 million for some firms. Their implementation time ranged from 8 - 18 months, with most estimates around 13 months. Estimates for on-going monitoring costs were generally around $175,000, but ranged up to a high of $250,000 for some firms.

3. Circuit Breaker that Triggers a Prohibition of Short Selling

a. Larger firms' cost estimates for implementing this proposal were generally around $850,000, but several firms also reported estimates up to $5 million. Their estimates for implementation time were generally around 6 months, but ranged up to 9 months for some firms. On-going monitoring costs were estimated generally around $100,000, but some firms provided estimates up to $750,000.

b. Regional firms provided estimates for their implementation costs that were generally around $225,000, but some firms provided estimates up to $500,000. Their estimates for implementation time generally were around 8 months, but ranged up to 18 months for some firms. On-going monitoring costs were estimated generally around $30,000, but ranged as high as $270,000 for some firms.

c. Clearing firms provided estimates generally around $1.2 million for implementation costs, but up to a high of $2 million for some firms. Their estimates for implementation time ranged from 8 - 18 months, with most estimates around 13 months. On-going monitoring costs were generally estimated to be around $175,000, but with a range up to $250,000 for some firms.

4. Circuit Breaker that Triggers a Modified Uptick Rule (Bid Test)

a. Larger firms' cost estimates for implementing this proposal were generally around $2 million, but ranged up to $9 million for some firms. Their estimates for implementation time were generally around 9 months, but ranged up to 15 months for some firms. On-going monitoring costs were estimated generally around $130,000, but ranged up to $1.5 million for some firms.

b. Regional firms provided estimates generally around $235,000 for their implementation costs, with a range up to $500,000 for some firms. Their estimates for implementation time were generally around 9 months, although some firms provided estimates up to 18 months. Estimates for on-going monitoring costs were generally around $45,000, but the range in estimates went up to $350,000 for some firms.

c. Clearing firms provided estimates generally around $1.2 million for their implementation costs, but with a range up to $1.9 million for some firms. Their estimates for implementation time ranged from 9 - 18 months, with most estimates around 14 months.

Estimates for on-going monitoring costs were generally around $175,000, but ranged up to $250,000 for some firms.

5. Circuit Breaker that Triggers the Uptick Rule

a. Larger firms' cost estimates for implementing this proposal were generally around $2 million, although some firms estimated up to $10 million. Their estimates for implementation time were generally around 9 months, with some firms estimating up to 16 months. On-going monitoring costs were generally estimated to be around $130,000, but some firms estimated up to $1.5 million.
b. Regional firms provided estimates generally around $250,000, with a range up to $500,000 for some firms. Their estimates for implementation time were generally around 9 months, although some firms estimated up to 18 months. On-going monitoring costs were generally estimated to be around $50,000, but some firms estimated up to $450,000.
c. Clearing firms provided estimates for their implementation costs generally around $1.1 million, with a high up to $1.9 million for some firms. Their estimates for implementation time ranged from 9 - 18 months, with most estimates around 14 months. Estimates for on-going monitoring costs were generally around $175,000, with a high of $250,000 for some firms.