The Honorable Mary Schapiro

Chairman, U.S. Securities and Exchange Commission

Subject: S7-08-09 Proposed Amendments to SHO

Date: 21 September 2009

Dear Chairman Schapiro,

The Commission has taken an important step in focusing on the alternative uptick rule as the approach to solving the short sale problem. It is simple to understand, easy to implement, requires virtually no technology costs, reduces compliance to making certain that short sales are properly marked, and most importantly, prevents short selling from proactively driving the price of a stock lower. Not only does it faithfully replicate the old uptick rule it improves upon it by making each and every short sale a liquidity providing transaction.

As best as I can determine, the Commission is proposing the alternative uptick rule be permanently implemented on a market wide basis. However, as the discussion switched back forth between the proposed uptick, modified uptick and alternative uptick rules, and what was then and what is now, it was not entirely clear to me as to whether its implementation would be based on a circuit breaker e.g. (10,15 or 20%). Imposing any circuit breaker would be a serious mistake. It will neither solve the problem Congress has with not returning to the uptick rule nor allay the public investor's distrust of the market and its belief that short selling drives stock prices lower. That mistake will be realized in the next significant downturn in the market and the Commission will be back before Congress having to prove that short selling was not a contributing factor. Hopefully, this request for comments will enable the Commission to take the responses and once and for all settle the issue.

The following are my responses to the specific questions.

<u>Renewal request for comments</u> (questions are paraphrased and commented on in chronological order; missing numbered questions are left deliberately blank):

<u>1.Effectiveness of the alternative uptick rule vs. proposed modified uptick rule or proposed uptick rule</u>: Short selling under the alternative uptick rule is a passive activity that is based on the current national best bid, a standard that drives the execution and order display protocols of all exchanges and market participants alike. With the rule prohibiting a short sale order from being immediately executable at the bid and having to await buying interest to proactively lift a short sale offering, the alternative uptick rule's effectiveness in preventing short selling from driving a price lower is near perfect. While the Commission has referenced the national best bid as the governing price it may be necessary to spell out whether that will be the bid disseminated by SIP or from direct data feeds. I am assuming that the Commission will choose the SIP generated bid in as much as it is the price that is available to all participants.

The two other approaches i.e. the proposed modified uptick rule or proposed uptick rule both require an accurate sequencing of bids and executions and could, at best, only come close to achieving what the alternative uptick rule can accomplish. It would take a huge technological effort to get the sequencing even close, and with short sales taking place in many execution venues, one could still never be certain that short selling was not taking place at lower prices.

2.What effect would the alternative uptick rule have on the benefits of short selling, such as providing price efficiency and liquidity: The single benefit that short selling provides is to artificially expand the supply side of the equation by selling short to satisfy the buying demand in a stock that has run up in price and the short seller perceives to be overvalued or over extended as to price. If that is what is meant by pricing efficiency then the alternative uptick rule has zero impact i.e. short sellers can continue to take advantage of their perception that the market for a stock is over extended for whatever reason and over any time frame, even if only seconds in time. If price efficiency means creating volume at the smallest possible price increments which for the most part comes from the capability of computer generated algorithms, designed to detect moment to moment trends or to "sniff" out the intentions of institutions (which has led to the creation of the dark pools to foil such efforts) and to effect millions of orders and billions of shares in ever faster time frames now measured in micro seconds, then I would say the alternative uptick rule would have a negative (from the short seller's perspective) impact on this computer generated activity – at least to the degree that this activity is dependent on unrestricted short selling at the bid. This elusive "price efficiency" is merely the byproduct of computer programs getting in between the natural buyers and sellers of stock- sort of a modern version of market makers taking advantage of the 1/8th spreads.

As it relates to liquidity, the alternative uptick rule, in place all the time, would have the positive benefit of providing liquidity on each and every transaction. The antitheses to this approach i.e. allowing the unrestricted selling on a down bid (either under some circuit breaker approach or simply unrestricted short selling) is never adding liquidity- as I pointed out with numerous examples and scenarios in my June 19th comment letter. Lastly, when the exchanges start paying a rebate for a short sale that hits a bid that is more than the rebate paid to a limit order posted and executed on the exchange, then you might give some credence to these short sales adding liquidity.

3.Programming issues for trading and surveillance systems: If short sales were required to be marked "post only" as an additional tag under the alternative uptick rule, there is no programming required on the part of the exchanges accepting the orders. The sequencing of bids and executions under the other proposals would have required an enormous programming effort on the part of the exchanges and participants. None of that is necessary with the alternative uptick rule and as mentioned previously, surveillance consists primarily of making certain short sales are marked as such.

5.If the Commission were to adopt a circuit breaker rule, should the circuit breaker, when triggered, result in the alternative uptick rule? The direct answer to the question is yes, but If the Commission adopts a circuit breaker in conjunction with the alternative uptick rule, then you will have done little to nothing to control the effect of short selling in a down market save for one scenario- the price of the stock cannot be driven to zero in the space of a day due to short selling. The whole concept is problematical for the very reason that it allows unrestricted short selling to continue as the prevailing mode of operation. The discussion on spreads, liquidity, price discovery, trading ranges and compliance, in my June 19th comment letter, set out the reasons why continuation of unrestricted short selling and the use of a circuit breaker were detrimental to the market. I will not repeat those arguments here but incorporate them in this comment letter by reference.

However, there are two additional points worth noting: (a) In the most recent market decline that lasted 17 months, stocks rarely went down on any given day by 10%, 15% or 20%. The exceptions were of course in the financial industry where there was a very real fear that the banks and brokerage industry would not survive- arguably, short selling may have even contributed to the run on certain of the banks. However, the unrelenting pressure of intraday, intra hour and moment to moment, short selling was (and will be in the future, if a circuit breaker concept is instituted) a factor in those price declines. Admittedly, price declines can occur without short selling as the root cause but whatever roll it plays, it will be negative, not positive. Short selling will, at every instance until the circuit breaker is triggered, be accelerating the declines and usurping the limited buying interest that might otherwise be accessed by long sellers. All in all, utilizing the circuit breaker basically means that unrestricted short selling will be in effect for all but a very small percent of the time, even in times of steep market drops (b) By adopting the alternative uptick rule, a huge technology effort that would have been required by the other proposals was avoided. Adoption of the circuit breaker will re-introduce a whole new level of technology effort on the part of exchanges and market participants. Calculating, displaying, monitoring for compliance, assigning responsibility for compliance, developing schemes to deal with errors and system failures, are just some of subjects the Commission will have to address just to track these trigger points on a daily basis; and each stock will have a new unique trigger point each and every day. Moreover, the overall percentage trigger point chosen will be arbitrary and unsuitable for the vast majority of stocks. A standard that might have some validity for a heavily traded speculative issue would be entirely inappropriate for a utility, where it may normally take six months to exceed a trading range of 10%. An eighty dollar stock will trade differently from a five dollar issue - these are just a few examples of just how complicated a circuit breaker can be.

For these reasons and the others I commented on previously, tacking on a circuit breaker to alternative uptick rule, causes one to go from: (a) virtually no technology effort to a very large one, (b) a simple concept to understand to having a complicated electronic scorecard that will be impossible for everyone save for the computer generated orders to keep straight, (c) a fair standard for all stocks to an arbitrary trigger point that will unfairly disadvantage many stocks, and (d) a simple compliance effort to a vastly more complicated one.

<u>Supplemental Comment Requests</u>:

<u>*1, 2,4,5 and 6. Effectiveness of alternative uptick rule in a down and up market, manipulation etc:*</u> Because the alternative uptick rule requires a buyer to lift a short seller's offer, short selling cannot "cause" the market to decline. Assuming that all aspects of locating, delivery and settlement requirements are met and the short sale is accurately marked and placed in queue for an execution, no abuse can occur if the short seller is not the initiator of the trade. It takes a willing and active buyer to cause a trade to occur.

I can envision, however, computers generating an offer to sell short after each execution so as to effectively cap the stock on the upside and to the extent a willing buyer comes into the market, the market could still tick down to the next level of bids resident in the system. Repeatedly flashing large sell orders and immediately cancelling or bunching multiple large offerings in penny increments above the market, could also have the effect of driving bidders away causing the market to drop to a lower level. The intent being to manipulate prices lower to benefit a short position generated through a derivative product or through other financial instruments created off board. Also, since computerized trading has driven the per share trade down to only a few hundred shares, it is not a significant leap to use the computers to manipulate share prices down by using odd lots which typically pass under the surveillance radar(I have seen no specific reference of odd lots being covered by the alternative uptick rule). The SEC will have to determine if any of these activities constitutes manipulation.

I have included in virtually every communication I have had with the Commission the notion of displaying on a real time basis the short sale volume. Nothing cleans up manipulative behavior like letting everyone know what, when, and how it is occurring. Knowing that the last sale was a short sale as well as being able to query the cumulative volume of short sales on a real time basis would have a prophylactic effect on short selling in general and more specifically on any manipulation using short sales, the equal of any rule; having said that, the availability of everyone seeing the "book" may have the opposite effect. It is the distinction of transparency regarding what has occurred versus transparency of what buyers and sellers intentions are. Why should anyone know what mine or anyone else's intentions are? When limit order visibility gradual moved from the providence of the specialists and market makers it was never addressed by the Commission as being harmful because it had the appearance of making those bids and offers available to everyone.. No one was privileged. Well intentioned but the effect was to tilt the actual access to computerize trading operations. When there is any movement at all in a stock today, the notion of the investor having access to the limit orders is a one in a million shot and a lucky one at that. So once again, the privileged few i.e. the specialists and market makers are replaced by the privileged few – those utilizing high speed computers. However, if the Commission were to change the rules to limit visibility to the national best bid, a slight risk is introduced that is not present today. As it stands now, the presence of limit orders and the speed of the computer limits their risk to a quantifiable amount. The uncertainty and risk of not knowing the extent of demand that one may be shorting into or overhead supply for those buying would dramatically change the equation. In my opinion, the effect would be to: (1) to a degree, level the playing field for the investor vis-a-vis computerize trading (2) it would put a greater emphasis on valuing a stock at a price versus generating billions of shares daily from minute price change algorithms and for the sole purpose of extracting pennies per share from limit orders at various price levels and (3) it may make it unnecessary for institutions to use dark pools to effect position changes of large size..

Lastly, nothing will prevent those willing to violate rules to manipulate a stock, either directly in the equity market or indirectly through other financial instruments off board.

In an up market, the short seller will get at least a one cent incremental positive difference under the alternative uptick rule vs. hitting the bid.

3. Restoration of investor confidence: Short selling is just one of several aspects of the financial markets that must be addressed but the short answer is yes. It will take an educational effort explaining what the differences are between the alternative uptick rule and the old uptick rule/ bid test. The fact that it is superior to both in not allowing short selling to drive prices lower should go a long way in eliminating short selling as an issue. Equally important are the public companies concerns about the impact short selling has on their company stock. The alternative uptick rule should allay those concerns as well.

However, if the Commission is seriously considering the circuit breaker as some sort of compromise position then I would suggest you leave the rules as they are today – the ultimate result will be virtually the same. It would at least save everyone the compliance headache and technology cost of creating a complicated electronic scorecard that will have virtually no effect on short selling in the marketplace.

8. Impact on Trading systems and strategies: The alternative uptick, without a circuit breaker will negatively impact these trading systems, at least to the extent that they profit from hitting bids, and covering at lower prices. Since there is no flat prohibition, the real difference is an element of risk has been inserted into the equation and at least momentarily, the execution is counter to the trend. Looking at it from the bright side, these trading entities will be paid a rebate for posting their short sale limit order on one of the exchanges.

10 11 and 12, Implementation of the alternative uptick rule: If the circuit breaker is not included the rule change will avoid virtually all technology cost and associated implementation delays. As has been described before, requiring short sellers to tag short sale orders as "post only" enables the exchanges to accept these orders today . If the exchanges will be required to make the determination whether to post the order or to reject the order, if it is not eligible for posting – it may take more than the suggested two months to implement the technology changes.

14 and 15: Exemptions and exceptions: The Commission has outlined numerous scenarios for exceptions to the rule, As a general statement, I would urge the standard to be - deny an exception if the effort is to simply lay off the risk of being long in one market and short in the equity market. There is nothing to prevent participants in other markets from reversing the process and getting short stock in accord with the alternative uptick rule and then going long the instrument in its own market. Put another way, why should the lack of liquidity in a derivative market be a free pass for usurping liquidity from the equity market.

18 and 20. Promotion of efficiency, competition and capital formation – the best approach: The most important function of the capital markets is to raise capital for American corporations. This cheap capital may be the only advantage these entities have to compete in the global economy – and ultimately drive the engine that creates jobs, prosperity and the wealth of this country. The public investors and the institutions who invest the vast majority of America's money are at the very core of that capital formation effort. Treating investors fairly is very important and right now they do not think having unrestricted short selling is a fair proposition. On the other hand, it is impossible to link computerized trading of billions of shares daily with no restrictions on short selling to this goal of improving the formation of capital. Investors vs. computerized trading - the choice the Commission makes will clearly show which of the two they believe to be of greater importance. In my opinion, by adopting the alternative uptick rule, the Commission will have chosen the best approach to deal with the loss of confidence by Congress and most importantly the investing public. Allowing unrestricted short selling in general or through the device of a circuit breaker would be a monumental mistake - for the market, for investors and for the SEC.

Markets will not stop declining, and even declining precipitously, but with the alternative uptick rule permanently in place <u>short selling will no longer be the cause of or contributing to the problem.</u> Making this choice will not produce a major upheaval in the market. The elusive, ill defined, much touted price efficiencies and liquidity will not suffer. People will adapt, strategies will change and the market will go on.

Respectfully,

Glen Shipway

Public Investor

<u>Final note on market data and analysis</u>: In virtually all the questions this request to prove one's point with data and analysis, was made almost on a pro-forma basis. In many cases I was at a loss as to even think of what kind of data would make sense, let alone where one could go to find it. Moreover, as a public investor with access to a laptop computer- does the Commission expect the public to have access to this kind of information and to be able to manipulate it into some sort of coherent analysis? Putting this kind of request in almost every instance could impede the public from commenting when they are left with feeling that their own observations and experience is somehow deficient. Also, in my own experience in dealing with studies, I have found that where analysis has been done in support of a position and that data is at odds with logic, then the odds are the data is either wrong or fails to account for all the variables. I would urge the Commission to examine carefully any such studies submitted or referenced for the motivation, biases, design and environment of the studies conducted, before the conclusions drawn are given any credence.

cc: Congressman Barney Frank, Chairman – Financial Services Committee

Congressman Gary Ackerman, Financial Services Committee

Senator Theodore Kaufman

Senator John Isakson