September 21, 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. 34-60509: File No. S7-08-09;
Proposed Amendments to Regulation SHO (Alternative Price Test)**

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 re-opened the comment period to provide an opportunity to comment on an alternative price test that would allow selling only at a price above the current national best bid ("alternative uptick rule") as a permanent price test restriction or in conjunction with a circuit breaker. The Release notes that the alternative uptick rule would restrict short selling to a greater extent than the other price tests proposed by the Commission because it would not allow short sales to achieve immediate execution even in an advancing market.

In its earlier comment letter filed on June 19, 2009,[3] SIFMA had indicated that, while firms understand and thoroughly support the Commission's efforts to restore investor confidence and facilitate stable and orderly markets, there is not sufficient evidence that these goals would be promoted or achieved in any measurable sense through new short sale price test restrictions. This position is equally true today, and while SIFMA will not repeat here all of the arguments made in its previous comment letter, it wishes to incorporate them by reference herein. Additionally, since the filing of the previous comment letter, market conditions have appeared to stabilize further, with concomitant positive impacts on investor confidence. In light of the

[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. 60509, 74 FR 42033 (August 20, 2009) ("Release").

[3] http://www.sifma.org/WorkArea/showcontent.aspx?id=12032

seeming stabilization of the financial markets and restoration of investor confidence, SIFMA would respectfully request that the Commission proceed with particular caution in enacting any regulations which could result in the introductions of certain inefficiencies into the markets at this delicate time in their recovery.

SIFMA would contend that there continues to be a lack of any evidence supporting the argument that the Commission's prior action in removing all short sale price tests was somehow flawed or did not properly consider the impact of such action under adverse market conditions, such as those experienced in the summer and fall of 2008. Additionally, SIFMA notes that, as of the beginning of August 2009, the Commission now has at its disposal a whole new set of short sale data that may be analyzed. Specifically, the Commission has now coordinated with the various self-regulatory organizations to publish aggregate short sale information on a daily basis, as well as individual transaction-specific data on a one-month delayed basis. SIFMA would respectfully urge that the Commission, prior to acting on this or any of the other price tests previously proposed, commission a study of this data (in a sufficiently large and, thus, reliable, sample size) to determine whether it provides any evidence supporting the reinstatement of a price test as being beneficial to the markets.

Furthermore, it remains the case that many commenters on the Release continue to mistakenly believe that re-instituting a price test would serve to curb "naked" short selling abuses. In addition to the fact that the price test is, quite simply, wholly unrelated to and not designed to address abusive naked short selling, the Commission has continued to take proactive steps to halt this practice that, by all accounts, have been quite effective. As discussed more fully later in this letter, this includes, most notably, the Commission's recent adoption of Rule 204 on a permanent basis, 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. The Commission also has recently brought significant enforcement actions targeted at naked short selling abuses by certain market participants. This follows on other actions by the Commission, such as the prior adoption in the fall of 2008 of 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.

Accordingly, SIFMA respectfully restates its prior recommendation that the Commission not act based on little more than the hope that a positive outcome will result from instituting a price test. Taking action based on the hope that it will boost investor confidence without it being supported by substantial evidence could lead to unintended and negative consequences for our capital markets and all investors – large and small. We urge the Commission therefore not to proceed without having clear objectives and a reasonable basis to believe that the action it takes will achieve such purpose, taking into account the significant costs of price test regulation (as evidenced by figures presented by SIFMA in the previous comment letter) as balanced against any (yet to be substantiated) potential benefits.

Notwithstanding all of the arguments presented that weigh against re-institution of a price test, if the Commission does determine, based on its review and analysis of empirical data, that short sale price test restrictions are necessary to restore investor confidence or to further address abusive trading activity, then SIFMA continues to believe 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. Furthermore, any price test must not sacrifice the essential market benefits to all investors provided by short selling and, accordingly, must contain certain essential exemptions so as to support those market efficiencies resulting from legitimate short selling activity.

There continues to be a general consensus among member firms that 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. With regard to the parameters for a circuit breaker, 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 caused by abusive or abnormal trading activity that would warrant additional price test restrictions. Rather, 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. Accordingly, we believe an appropriate trigger should be based off of a higher percentage decline, such as 15% or 20%, which may be more indicative of unusual market activity perhaps warranting trading restrictions. 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 stocks in the under $10 category that might otherwise be triggered in the absence of abnormal activity. In addition, we suggest that the Commission 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 the appropriate trigger for any circuit breaker, so as to establish the most efficient measures to minimize market disruption.

With respect to the proposed alternative uptick rule, certain firms would favor this price test (again, as part of a circuit breaker approach) over the previous price test proposals, as they believe that any price test such as those which is based instead on a sequence of bids or last sale prices will raise significant compliance issues due to problems associated with, respectively, bid flickering and trade reporting latencies. These firms would recommend that the Commission adopt an approach similar to Regulation NMS (*i.e.*, look exclusively to the current best bid) as the applicable benchmark. Certain firms note that a passive bid test may be easier to implement and monitor than the previous bid test proposed by the Commission, as market centers would need to focus only on the current national best bid ("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 the ability to focus exclusively on, and to address, these situations. Many SIFMA firms recommend that compliance with any proposed short sale price test should be implemented via a policies and procedures approach, much like the approach mandated for compliance with Regulation NMS.

SIFMA firms continue to feel strongly that, if the Commission does adopt a price test (including the proposed alternative uptick rule), the rule must contain certain essential exceptions to ensure the efficient functioning of the markets and that investors and issuers are not negatively impacted by a decline in essential liquidity. These exceptions are especially important in connection with the alternative uptick rule given that such a proposal would restrict short selling to a greater extent than the other price tests proposed by the Commission, since the alternative uptick rule would not allow short sales to receive immediate execution even in an advancing market. Moreover, retail investors would be likely to receive executions that are inferior to those received today if such exceptions were not included in any such rule. Such exceptions 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; (v) exchange traded funds and similar broad-based indices and baskets of stocks; and (vi) short sales that occur as a result of executions at a midpoint between the best bid and offer. SIFMA provided in its previous comment letter extensive discussion concerning the necessity of these exceptions, as well as the parameters of the exceptions, which should be incorporated herein.

We note that it was approximately one year ago when the markets struggled to implement the two short sale emergency orders of September 2008, *i.e.*, the "No Fail Order" of September 17 and the "No Short Sale Order" of September 18. The lessons learned from that experience should be remembered. In particular, we note that:

(i) Liquidity in general decreased significantly in all stocks and decreased more so in the 799 targeted stocks.[4]

(ii) When option market makers concluded, on September 19, that their stock hedges were not exempted from the pre-borrow requirement and were subject to a strict mandatory buy-in requirement, they withdrew liquidity to a staggering degree. Indeed, the bid/ask spreads for option quotes tripled in width on that day from their usual widths, which resulted in much higher trading spread costs to investors.[5]

The lessons of September 2008 should not be lost in the current debate; they serve as a stark reminder that essential exceptions should be in place to ensure the full participation of needed liquidity providers.

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4 Study titled "Shackling Short Sellers: The 2008 Shorting Ban," Boehmer, Jones and Zhang.

5 Study titled "Hastily Implementing Rules that are not Well Thought Out: The Impact of the 2008 Short Sale Ban on Equity Option Markets" by Robert Battalio & Paul Schultz, both of the Mendoza College of Business at the University of Notre Dame.

In addition to the foregoing (and on a related topic), SIFMA notes that a number of commenters on the short sale price test proposals continue to recommend that the Commission impose a "pre-borrow" requirement prior to effecting short sales. These commenters recommend this requirement to address an issue – timely delivery of short sales – that has already been successfully addressed by the SEC's adoption of Rule 204. SIFMA firms remain strongly opposed to any such proposal on the basis that such an approach could give rise to grave, unintended consequences. As stated in our prior comment letter, surveys that SIFMA conducted of member firms after the Commission's July Emergency Order showed that the observed impacts of the pre-borrow obligations imposed by the order included: (i) a significant reduction in stock loan liquidity in some of the subject securities; (ii) significantly higher borrowing costs; (iii) substantial balance sheet costs for many firms related to financing pre-borrows, which ultimately impacted such firms' efficient use of capital; and (iv) reduced liquidity in the market, resulting in wider spreads and greater volatility.

Moreover, as stated in our previous comment letter, 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 the 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,[6] due to, among other reasons, the potential seller ultimately deciding not to effect the short sale transaction, or the securities otherwise being purchased the same day to cover the short sale, thus netting out a firm's delivery obligations in the continuous net settlement ("CNS") system. 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,[7] each of which generally concluded that the pre-borrow requirement had the effect of reducing liquidity and increasing borrowing costs.[8]

These adverse impacts to liquidity and borrowing costs – which will ultimately be borne by investors – would be unnecessarily imposed given that Rule 204 has already had a significant positive impact in reducing fails. According to the SEC's own estimates, Rule 204T (the predecessor to Rule 204), among other actions taken by the SEC, resulted in the average daily number of fails to deliver for all equity securities declining from 1.1 billion to 478 million for a total decline of 56.6 percent. In addition, the average daily number of threshold securities declined from 480 securities to 108 securities in comparing the pre- to post- temporary Rule 204T adoption period, a decline of 77.5%.[9]

SIFMA believes that, should the Commission determine to adopt a price test, it should provide sufficient time for firms and trading centers to implement and update technology in conformity with any such rule. It is our view that the two-month implementation period

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6 Estimates from member firms are generally that less than 10% of all locates result in an actual short sale.

7 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.

8 *See also* Bris, "Short Selling Activity in Financial Stocks and the SEC July 15th Emergency Order," August 2008.

9 Securities Exchange Act Release No. 60388, 74 FR 38266 (July 31, 2009).

proposed by the Commission is not adequate, and, instead, propose a minimum period of nine-twelve months after approval to allow for the resolution of any outstanding interpretative questions raised by any rule, and the subsequent programming and testing of systems. Moreover, any such changes must be examined in the context of current programming mandates before firms, including options symbology, potential changes to marking of orders pursuant to the recently-released SEC Regulation SHO FAQs 2.4 and 2.5, and trade reporting system changes due in Q1 2009. 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 industry's 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.

Finally, we also wish to remind the Commission of its ongoing discussions with SIFMA member firms regarding the impact of recently enacted Regulation SHO FAQs 2.4 and 2.5. SIFMA has significant concerns with the effects of these FAQs and believes that they may be inconsistent with the order marking protocols contained in Regulation SHO. Additionally, member firms believe that, as a practical matter, adherence to these FAQs in their current form will result in a substantial over-marking of orders as "short" in situations where firms are, in fact, "long" the securities being sold, as indicated by their aggregation unit or firm-wide positions. SIFMA member firms are further concerned that any increase in short sale orders (resulting from such over-marking), when coupled with a reinstated short sale price test, will further exacerbate the negative impacts on market liquidity and efficiency resulting from such price test.

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

Ira D. Hammerman
SIFMA Senior Managing Director and
General Counsel

cc: The Hon. Mary Schapiro, Chairman
The Hon. Kathleen Casey, Commissioner
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