S7-23-03

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December 26, 2003

Jonathan G. Katz, Secretary
Securities and Exchange Commission
450 Fifth Street NW
Washington, DC 20549-0609

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OFFICE OF THE SECRETARY

Re: File No. S7-23-03

Dear Secretary Jonathan G. Katz,

I am writing this letter in reference to File No. S7-23-03, in order to voice my opposition to the proposed bid test change within Regulation SHO. Additionally, I'd like to suggest an expansion of the pilot program for unrestricted short selling.

Requiring a short sale to be effected at least one cent above the best bid contradicts the purpose of short selling. The SEC explains that short selling adds liquidity and efficiency to the marketplace, yet this proposed rule would make it harder for orders to be matched and would not fully reflect all buy and sell interest. As of now, if I want to execute against a high bid to get short, I am able to, whereas the proposed restriction would make this more difficult, even in an advancing market. Whether my short sale is either a speculative play reflecting my belief that a security is overbought, or if its purpose is to hedge risk, it makes no sense to delay or perhaps prevent my desire to sell short. If I am willing to short at a lower price and pay the ECN transaction fee (and let the buyer receive the rebate), I should be able to do so. This is the basis of a free market, and certainly, as a frequent buyer of securities, I prefer to have my buy orders executed quickly and at the best prices possible. It is of no concern to me as a buyer if my order gets matched with a long sale or short sale. I just want to buy, and I believe that the market is better off if every investor's intention and evaluation is observed without restriction.

The SEC states that its concern with short selling is that it can be used as a tool for driving the market down, inducing investors to panic. Specifically, the proposal mentions that this could occur if a seller is "exhausting all remaining bids at one price level". However, this is an unfounded fear given our current system. If there is an uptick, and the short seller can execute against it, by definition there are other bids remaining just beneath that price. The subsequent downtick preserves the level from being wiped out. Therefore, a short seller cannot drive a security down. The proposed rule change is not necessary to protect against this act, as the current bid test rule already offers sufficient defense.

If anything, there could be the unintended consequence of increased downward volatility if this proposal gets enacted, as buyers can be frightened by large or refreshing offers. In a notable example, on December 5, 2003, a large (albeit accidental) offer appeared in the security COCO. The stock went down at least a few points before that first sell order was executed against. If it were a normal order, and if it were programmed to hit the bids for the same amount of shares, given the stock's volume, the security would not have dropped nearly as much. I use this extreme example to explain what I've seen many times on a much smaller scale—that the presence of large offers cause downward panic and the cancellation of bids. Therefore, encouraging short sellers to put in more offers could very well increase volatility, in addition to a definite reduction in liquidity.

In congruence with my opposition to the proposed bid test change, I'd also like to encourage additional deregulation regarding short selling. The SEC is concerned that "bear raids" might cause investors to believe that there is a fundamental problem with a stock if a price decline is increased. However, that begs the question: What if there is a fundamental problem? If a stock is up 1000 percent over the course of the year, but today it is down 10 percent and there is bad news on it, should I really not be allowed to short the security? If I think that it is still overbought, shouldn't I be able to act on that belief? Or if that same security is down considerably, but I think it is oversold and want to buy across a favorable spread, wouldn't I be glad to have a short seller execute against my bid?

I believe a free market works best when the players are given control to do as they wish. I'm pleased that the SEC wants to create a pilot program to study unrestricted short selling. My only comment is that if the study is to be complete, that it should include a broader base of stocks. Instead of only using a few hundred stocks of high liquidity, I suggest that they use thousands of stocks of varying liquidity, as this would give a truer representation of the market.

Thank you for soliciting public comment on these matters.

Sincerely,

David Schwarz

David Schwarz
Registered Representative

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