

**VIA EMAIL AND FEDERAL EXPRESS**

June 21, 2011

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

**Re: File Number 4-627**

Dear Ms. Murphy:

We write you today in response to the Securities and Exchange Commission’s (SEC or Commission) Request for Comment with regard to studies mandated by Section 417<sup>1</sup> of the Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”). NYSE Euronext believes this study provides the SEC an opportunity to develop a sound framework for providing important short sale information to investors and other market participants. Indeed, properly done, the studies required under Section 417 of the Dodd-Frank Act should result in proposals to increase transparency and investor confidence by further reducing the opacity and suspicions of market manipulation that often surround short-sale trading.

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<sup>1</sup> SEC. 417. COMMISSION STUDY AND REPORT ON SHORT SELLING.

- (a) **STUDIES.**—The Division of Risk, Strategy, and Financial Innovation of the Commission shall conduct (1) a study, taking into account current scholarship, on the state of short selling on national securities exchanges and in the over-the-counter markets, with particular attention to the impact of recent rule changes and the incidence of (A) the failure to deliver shares sold short; or B) delivery of shares on the fourth day following the short sale transaction; and (2) a study of (A) the feasibility, benefits, and costs of requiring reporting publicly, in real time short sale positions of publicly listed securities, or, in the alternative, reporting such short positions in real time only to the Commission and the Financial Industry Regulatory Authority; and (B) the feasibility, benefits, and costs of conducting a voluntary pilot program in which public companies will agree to have all trades of their shares marked “short”, “market maker short”, “buy”, “buy-to-cover”, or “long”, and reported in real time through the Consolidated Tape.
- (b) **REPORTS.**—The Commission shall submit a report to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives—(1) on the results of the study required under subsection(a)(1), including recommendations for market improvements, not later than 2 years after the date of enactment of this Act; and (2) on the results of the study required under subsection(a)(2), not later than 1 year after the date of enactment of this Act.



Ms. Elizabeth M. Murphy

June 21, 2011

Page 2 of 7

Therefore, we respectfully offer the following recommendations in response to the SEC's Request for Comment in fulfilling the study required under Section 417 of the Dodd-Frank Act. We also hope that the SEC will look to the NYSE Euronext as a resource to assist the Commission in implementing its recommendations.

***I. Section 417(a)(1): State of Short-Selling On National Securities Exchanges and in the Over-The-Counter Markets – The need to monitor short selling behavior.***

To its credit, the SEC has adopted several new rules in recent years to improve the practices involved in executing, clearing and settling short sales. For example, the newly enacted Rule 204T directs that a broker dealer who fails to deliver shares sold short may not engage in additional short sales in that security without a pre-borrow or a clear and specific agreement to borrow the shares.<sup>2</sup> The SEC also recently amended Regulation SHO to enhance the delivery requirements for equities sold short and narrow the definition of *bona fide* market-making transactions that remain exempt from delivery requirements. Most recently, the SEC also instated a new version of the so-called “uptick” rule, which restricts short sales of any stock that triggers a circuit-breaker by falling in price by 10% or more within one day.<sup>3</sup>

These new SEC rules have almost certainly reduced the gross number of fails-to-deliver (“FTDs”).<sup>4</sup> However, FTDs continue at significant levels, especially for a discrete number of companies and exchange traded funds (“ETFs”). Until we are certain that illegal naked short sales have been effectively eliminated, the markets will remain vulnerable to firms being potentially besieged by rumors and misinformation, followed by large-scale naked short selling.<sup>5</sup>

In fact, the data show that despite the SEC's substantial progress in regulating FTDs, issues remain. The most-recent SEC data on FTDs show that on May 13, 2011, outstanding FTDs totaled 305,264,811 shares. In addition, a consistent high concentration of failures in individual symbols raises questions about the continued prevalence of naked short selling. However, the

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<sup>2</sup> “The temporary rule imposes on the participant for its own trades and on all broker-dealers from which that participant receives trades for clearance and settlement (including introducing and executing brokers), a requirement to borrow or arrange to borrow securities prior to accepting or effecting further short sales in that security.” Amendments to Regulation SHO, Exchange Act Release No. 34-58773; 17 C.F.R. § 242. IV. B (2008).

<sup>3</sup> Amendments to Regulation SHO, Exchange Act Release No. 34-61595; 17 C.F.R. § 242 (2010).

<sup>4</sup> In addition, the SEC has proposed new “Rule 613 under Section 11A(a)(3)(B) of the Securities Exchange Act of 1934 (“Exchange Act”) that would require national securities exchanges and national securities associations (“self-regulatory organizations” or “SROs”) to act jointly in developing a national market system (“NMS”) plan to develop, implement, and maintain a consolidated order tracking system, or consolidated audit trail, with respect to the trading of NMS securities.” **[Release No. 34-62174; File No. S7-11-10, see <http://www.sec.gov/rules/proposed/2010/34-62174.pdf>.]** The Section 417 studies also offer an opportunity to assist in creating that audit trail.

<sup>5</sup> Robert J. Shapiro and Nam D. Pham, [The Impact of a Pre-Borrow Requirement for Short Sales on Failures-to-Deliver and Market Liquidity](http://www.sec.gov/comments/s7-08-09/s70809-3984.pdf), April 2009. <http://www.sec.gov/comments/s7-08-09/s70809-3984.pdf>.



Ms. Elizabeth M. Murphy

June 21, 2011

Page 3 of 7

FTD data also includes failures on long sales, which necessitates an examination of whether the high concentrations of failures are evidence of naked short sales. Because the data represent total shares outstanding as of a given date, there is no direct way to determine how long the FTDs have been outstanding in a given security from the data in the bi-monthly SEC report. The SEC threshold list does indicate how long a given level of FTDs has been outstanding, but the age of particular failures is unknown. The data also include fixed income securities.

Accordingly, the SEC should continue to strictly and carefully monitor short-selling activity with the recent changes in effect. In particular, we urge the Commission to analyze aggregate short sales and FTDs in the markets, and study the behavior of short sales and FTDs in public securities and ETFs that historically have experienced the greatest short sale activity. It is important that the SEC focus on FTD activity and the reasons why such FTDs are created and resolved or not.

We further urge the SEC to establish whether all FTD activity (including FTDs generated by prime brokerages, hedge funds and broker-dealers) is included in the official FTD data that the SEC monitors and reports. In addition, it is our understanding that the data used to monitor FTD activity does not include or disclose ex-clearing or rolled transactions, the materiality of which is not known. Finally, we believe the SEC also conduct a study tracing short sale trades to their origins in the stock loan market, in order to determine and root out inefficiencies.

## ***II. Section 417(a)(2)(A): Reporting of Real-Time Short Positions.***

We recognize that real-time reporting of the short positions of all securities, including ETFs, raises important issues. For example, there is no current capacity for real-time reporting using the form prescribed by the Dodd–Frank Act. In addition, there are legitimate questions as to whether reporting each position is meaningful to market participants since some short-sales result in economically neutral positions and we therefore suggest that net short positions is more meaningful data. As a result, we recommend that the SEC seriously consider not only the volume of the data contemplated to be disclosed but also the value of the data and which market participants would be most influenced by real-time reporting. We also believe the costs of implementation will significantly increase as any reporting requirement period is compressed and therefore the SEC should assesses the implementation costs associated with any reporting requirements.

NYSE Euronext recognizes that real-time reporting may raise confidentiality issues for some professional traders and fund managers, especially those with concerns that reporting their short positions in real time may reveal their trading strategies. However, the Dodd–Frank Act does not require that the traders be identified, only that the trades are reported in the aggregate.

To address confidentiality concerns, the SEC could consider two tiers of short position disclosure. The first tier could cover short-term (e.g., daily) reporting of equity short positions to the SEC and FINRA, so that regulators have daily access to such data. The SEC could exempt from this reporting requirement an appropriate de minimis amount that does not obstruct the reporting objective of the study (e.g., activity of less than a certain percentage of market capitalization). Recognizing that some markets and trading platforms do not have equivalent reporting systems and corresponding restrictions, we also believe the SEC should initially exempt derivative positions. Requiring the disclosure of only reported derivatives data would (i) inhibit an accurate



Ms. Elizabeth M. Murphy

June 21, 2011

Page 4 of 7

depiction of the true economic impact of derivatives positions; and (ii) give regulatory preference to less transparent derivatives trading.

The second tier of short position disclosure could cover a longer timeframe and would be publicly disclosed. The delay in the public reporting of short positions should alleviate concerns about revealing proprietary strategies. While achieving the correct balance between delay and transparency will be challenging, we believe it can be achieved. It remains important that investors and issuers have access to this information on a timely basis.

NYSE Euronext believes that in light of Section 929R of the Dodd-Frank Act,<sup>6</sup> the SEC should align short-sale disclosure timelines with those required under Securities Exchange Act Section 13(d) and 13(g), currently 10 day and 45 day disclosure periods, respectively. As discussed by the Commission in other recently proposed rules,<sup>7</sup> we agree that SEC staff should continue their project to develop proposals to modernize reporting under Exchange Act Sections 13(d) and 13(g). In particular, it may be worthwhile to revisit the cost and benefit tradeoff between shortening the disclosure timelines and the confidentiality concerns of market participants. After a period of analysis, the SEC could also examine the implications of modifying the delayed timeframe to evaluate some of the potential shortcomings such as noise in the data, difficulty in categorizing activity, and lack of participant identity. We also believe that the SEC should consider, after further analysis of a pilot, the concept of including derivatives transactions that might also have a directional impact on the price of a stock, with a particular focus on derivatives that have voting rights.

### ***III. Section 417(a)(2)B – A Pilot Requiring the Reporting of Trades through the Consolidated Tape.***

We believe that real-time end-of-day reporting of short selling activity would be relatively easy to carry out if the requirements covered simply long and short sales. Short sale data are generally available now, but they are not transmitted to the Consolidated Tape. As a result, it may be more prudent of the Commission to require all CTA participants to make end-of-day disclosure of the existing 204T data requirements to the Consolidated Tape. By adopting this approach, implementation of meaningful data could be implemented in a matter of months and would be publicly available for all investors to review. As discussed in our previous letter of October 10, 2010,<sup>8</sup> end-of-day reporting will negate the potential for momentum traders to have an impact on stock prices as a result of decreased or increased levels of short selling if reported in real-time. It

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<sup>6</sup> Dodd Frank Act Section 929R authorizes the SEC to adjust the allotted time requirements for disclosing Beneficial Ownership in a public company. See Dodd-Frank Act Section 929R (<http://www.sec.gov/about/laws/wallstreetreform-cpa.pdf>).

<sup>7</sup> Beneficial Ownership Reporting Requirements and Security Based Swaps. Exchange Act Release No. 34-64087; 17 CFR Part 240. BENEFICIAL OWNERSHIP REPORTING REQUIREMENTS AND SECURITYBASED SWAPS

<sup>8</sup> NYSE Euronext Letter Re: Section 417 of the Dodd-Frank Act. (<http://www.sec.gov/comments/df-title-ix/short-sale-disclosure/shortsaledisclosure-18.pdf>)



is also likely that adopting this approach will decrease the potential for unnecessary levels of volatility in listed companies.

The additional categories of “market maker short,” “buy to cover,” and “long,” require additional adjustments to the SIP,<sup>9</sup> unless the information for these categories is distributed through proprietary feeds. The NYSE could provide a proprietary feed for such information and likely the other market centers could as well, but this would require modification of order information by the sending firm which could drive up the cost of implementation and not result in a disaggregation of data that would be intelligible to only the most sophisticated market participants.

Although marking short sale trades by actual market makers separately may help in identifying genuine short sale positions, doing so would increase the level of complexity and associated costs and likely raise confidentiality concerns within the market maker community, particularly in those markets with a unitary market maker structure. As noted above, the Dodd–Frank Act does not require that the traders be identified, but identifying “market maker short” interest on certain markets would result in just that. Unless the “market maker short” tag is extended to those acting as market makers, as well as those registered as such, this exposure -- on a real time, trade by trade basis -- could negatively affect the registered market maker’s function.<sup>10</sup> For example, on NYSE, only Designated Market Makers (DMMs) are registered as market makers, which would make disclosure of their singular activity unfair. As such we do not believe there is currently a meaningful way to disclose activity as being market making in nature. We would, therefore, encourage the Commission to investigate this thoroughly prior to implementation of any such requirements. The SEC should also consider incorporating separate marking for *bona fide* hedging activity.

We also recommend that the subsection (a)(2)A study be constructed as a pilot to analyze the costs and benefits of requiring reporting of short positions.

In designing the Section 417 (a)(2)(B) pilot program, we recommend that the SEC consider these additional issues:

- **Who Participates** – The selection criteria for the companies participating in the pilot should accurately reflect the range of publicly-traded companies, including samples of large, medium, and small cap companies, companies traded on the NYSE, AMEX, NASDAQ and over-the-counter, companies whose shares are easy-to-borrow and hard-to-borrow, companies with large numbers of current and historical FTDs and small numbers of FTDs, and companies which are and have been Regulation SHO threshold stocks and those which are not and have never been.

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<sup>9</sup> Currently the equities FIX specification defines Tag 54 (Side) as either 1=Buy, 2=Sell, 5=Sell Short, 6=Sell Short Exempt. There is no specific market maker flag, but the 6 could be sufficient for this. There is also no order modifier for equities “buy to cover.” This, too, would have to be added. The addition of the buy to cover field could be accommodated by adding a trade side for buy to cover or more simply adding a user defined field that would be adopted for this purpose.

<sup>10</sup> Moreover, while much short selling activity may be market making in nature it may not signify a genuine short position,



One option may be to list all public companies, rank them by size, and then assign every tenth company to the pilot group. That process would generate a sample covering 10% of traded stocks; the other 90% of stocks would act as controls.

- ***An Option to Opt In or Opt Out*** – The Dodd-Frank Act suggests an opt-in structure for the pilot. We believe this will bias the sample and complicate the effectiveness and logistics of the study; as such a more objective methodology is preferable. The impact on trading behavior resulting from real time short-sale data being available to the markets is unknown. Thus, some companies may be reluctant to participate. Other companies may have a strong desire to participate in the pilot program. In addition, company opt-in may produce a non-random sample. One potential solution would be to conduct a separate sub-study of companies that want to opt-in to the program. This could be done by randomly accepting half of the opt-ins for the study and using the other half as controls. The administrators could pair off the opt-in companies by size, price, volume, industry, etc., and then randomly pick one from each pair. Similarly, a group of non-opt-ins could be randomly selected for the pilot to establish if there is any difference. However these results would still be biased versus an objective standard.
- ***Public Disclosure versus Private Reporting*** – For research and evaluation purposes, it may be helpful if the SEC conducted two sub-pilots: The short sale information for one sub-set of companies would be available to the general public during the pilot period, through the Consolidated Tape; while the short-sale information for a second sub-set would be collected and released publicly with a short lag. The second sub-set would act as a control group, so the SEC and outside analysts can determine the effects on trading activity of making short sale data public on an end-of-day basis.
- ***Reporting Requirements*** – The pilot would have to establish rules governing which party or agent will be responsible for reporting the information. These rules could be similar to current rules governing who is responsible for reporting executed trades.<sup>11</sup>
- ***Uncovered Short Sales*** – Despite requirements that broker-dealers borrow or allocate shares for their short-selling clients, there are hundreds of millions of FTDs in the market on any given day. The pilot must include a mechanism that will force those reporting short sales to separately identify uncovered and covered short sales.

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<sup>11</sup> See FINRA Rule 6182 that would need to be modified to include additional short sale information. [http://finra.complinet.com/en/display/display\\_main.html?rbid=2403&element\\_id=4387](http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=4387)



Ms. Elizabeth M. Murphy

June 21, 2011

Page 7 of 7

***IV. Conclusion.***

Again, we believe that Section 417 offers the SEC a unique opportunity to improve the public markets in a lasting way that will benefit investors and other market participants. We are available to assist and consult in any way the SEC requests in the design and/or implementation of any pilots implemented with regard to the aforementioned issues.

Respectfully yours,

*Janeth McHinness*