

September 21, 2009

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

Re: File Number S7-08-09

Dear Ms. Murphy:

NYSE Euronext, on behalf of all of its U.S. market subsidiaries, appreciates the opportunity to provide additional comments on the Securities and Exchange Commission’s proposed amendments to Regulation SHO. This letter responds to the Commission’s request for supplemental comments and feedback on an alternative price test that would amend Regulation SHO to allow short selling only at a price above the current national best bid (the “alternative uptick rule”). NYSE Euronext supports the Commission’s goal of restoring public confidence in the markets and agrees that some restrictions on short selling may advance that goal. Notwithstanding the proposed alternative uptick rule, however, NYSE Euronext continues to believe strongly that an always-on bid test would best achieve the Commission’s goal.

I. Background

In April 2009, the Commission issued its initial notice and request for public comment on the referenced proposal to amend Regulation SHO to adopt short selling price test restrictions. Although it solicited some comments on an alternative uptick rule, the Commission focused primarily on four other proposed alternatives – an always-on uptick rule, an always-on bid test, a prohibition on short selling that takes effect after a circuit breaker is triggered, or a price test (either the uptick rule or bid test) that takes effect after a circuit breaker has been triggered. After considering the various proposals, NYSE Euronext concluded that an always-on bid test was preferable to the other proposals, including the modified uptick rule that we and three other national securities exchanges suggested in March.¹ In our June 2009 comment letter, we noted, among other things, our belief that an always-on bid test is more predictable for market participants and issuers alike, would raise fewer implementation complexities, and is less likely

¹ See letter from NYSE Euronext, The Nasdaq OMX Group, Inc. BATS Exchange, Inc., and National Stock Exchange to The Honorable Mary Schapiro, Chairman, U.S. Securities and Exchange Commission, dated March 24, 2009 (available at <http://www.sec.gov/comments/s7-08-09/s70809-49.pdf>)



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to have a “magnet effect” on the pricing of a security as it approaches a circuit breaker trigger point.²

For the reasons set forth in our June 2009 letter and discussed below, NYSE Euronext continues to believe that an always-on bid test is preferable to the other proposals on short selling. With respect to the proposed alternative uptick rule, we believe it is likely to have a significant dampening effect on short selling, which would be too restrictive without a circuit breaker test and commensurate exemptions. However, and as discussed in detail in our June 2009 letter, we feel strongly that a circuit breaker approach raises significant effectiveness, structural and logistical concerns. Thus, adoption of the alternative uptick rule, with or without a circuit breaker is not optimal.

II. The alternative uptick rule is inferior to the bid test

A. The alternative uptick rule is too restrictive

The alternative uptick rule would significantly reduce short selling. As proposed by the Commission, whenever the alternative uptick rule was in effect (either all the time or as a result of a circuit breaker being triggered), short sell orders would be unable to execute other than at a price at least one increment above the prevailing national best bid (“NBB”). Thus, effectively short selling would only be permitted on a passive basis, and short sellers would not be permitted to “hit” bids since such orders would generally be executed at the NBB. Eliminating short sellers’ ability to take liquidity will result in a significant decrease in available selling liquidity. For example, during August 2009 short sale “takers” accounted for approximately 17% of trade volume on NYSE. The withdrawal of this level of liquidity would have a broad adverse market impact that would meaningfully reduce the benefits short sellers provide. While we wholeheartedly agree that short selling should be subject to reasonable restrictions that are designed to bring more order to a declining market and prevent cascading destabilizing selling, it is equally important that any restrictions not impose undue burdens or costs on legitimate short selling. As we noted in our June 2009 letter, properly regulated short sales enable markets to operate more efficiently, by contributing to price discovery, particularly when a security may be overvalued, and providing needed liquidity to smooth out temporary disparities between supply and demand. We do not believe that the alternative uptick rule will most effectively balance

² See letter from Janet M. Kissane, Senior Vice President – Legal & Corporate Secretary, NYSE Euronext, dated June 19, 2009 (available at <http://www.sec.gov/comments/s7-08-09/s70809-3786.pdf>).



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these competing objectives since it will have such a significant dampening effect on short selling.

B. The alternative uptick rule could only be implemented with a circuit breaker approach

The March 2009 joint exchanges letter suggested a circuit breaker approach that would trigger a restriction comparable to the alternative uptick rule. To the extent that the Commission determines to adopt the alternative uptick rule, NYSE Euronext believes that, because it is so restrictive, it can only be adopted with a circuit breaker. However, and as discussed below in more detail, a circuit breaker approach raises a number of inherent complexities and limitations. Accordingly, we recommend that the Commission adopt an always-on bid test.

III. Short selling restrictions triggered by a circuit breaker are less effective than “always-on” restrictions

A. Always-on restrictions are more likely to promote public confidence

In our June 2009 letter, we observed that it was an open question whether short selling was the primary culprit in the market declines of the past year. Events of the past few months would seem to bear out this observation, in that even in the absence of short sale price restrictions, key market indices have nevertheless seen increases of 50% - 75% from their lows in March 2009. This would suggest that factors other than short selling might have driven the market declines of 2008 and early 2009.

Notwithstanding recent market gains, however, many observers believe that the capital markets and public confidence therein remain fragile. In such an environment, unrestricted short selling may exacerbate an already declining price trend in a particular security or market segment, and thereby undermine public confidence in the markets. Accordingly, and fully recognizing that properly regulated short selling enables markets to operate more efficiently, we agree with the Commission that there should be some restrictions on short selling in order to bolster public confidence in the markets and promote orderly markets.

As explained more fully in our June 2009 letter, we believe that restrictions based on price-derived circuit breakers are less likely to accomplish this goal. By definition, such restrictions would be sporadic, since they would take effect only after a circuit breaker had been tripped, and unlikely to be perceived as a timely or effective remedy against abusive short selling, since



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restrictions would only take effect after there had already been a significant intraday price decline in a security. Circuit breakers may also undermine investor confidence because they introduce an element of uncertainty in the pricing of securities: at a certain point, the price of a declining security would begin to reflect not the fundamental value of the security, but rather the likelihood that a security will trigger the circuit breaker. This “magnet effect” could undermine investor confidence, resulting in less buying interest in securities nearing the circuit breaker if there is a perception that professional traders could use sophisticated pricing models to profit from this anomaly while public investors, lacking access to such tools, could not.

By contrast, an always-on bid test is predictable as to its effect on the market (i.e., there is no magnet effect that affects prices at particular times, since it applies to all securities in the same manner). An always-on constraint is also more easily understood by less sophisticated participants. Unlike a circuit breaker that requires active monitoring since it will apply only to some securities in any given day, and only during certain parts of the day, the always-on test is just that – always on. It would also avoid volatile spikes in a security’s price as it approaches and/or retreats from a circuit breaker level.³

B. Circuit breakers raise greater implementation complexities

As noted in our June 2009 letter, in addition to being less effective in restricting abusive short selling, we believe that a circuit breaker approach raises significant implementation complexities. Among other things, because circuit breakers would presumably apply on a security-by-security basis, there would need to be an effective method for calculating when a circuit breaker was triggered and communicating that to market participants.

In this regard, we strongly believe that the calculations and communication function should be undertaken on a cross-market basis by the Securities Information Processor (“SIP”) for the security in question. Such a role is consistent with the responsibilities of a SIP to collect,

³ NYSE Euronext data indicates that volatility increased as the Dow Jones Industrial AverageSM approached the NYSE Rule 80A circuit breaker levels, which required member firms entering index arbitrage orders to sell any component of the S & P Stock Price IndexSM to include a “sell plus” instruction on such orders. We believe that if a circuit breaker approach is used for a short sale restriction, it is likely that volatility will be even greater, both because Rule 80A applied only to a broad-based and thus naturally less volatile index or portfolio of stocks, and because individual stocks are more susceptible to manipulation.



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process, distribute and publish information with respect to transactions in or quotations for any security for which it acts as the SIP on a current and continuing basis. In view of the critical importance of ensuring that triggering of a circuit breaker is communicated to all markets and market participants in a fair, impartial and timely basis, it would be inappropriate to allow each market to perform its own calculation or to impose the responsibility on a particular market.

Any approach other than vesting such responsibility with the SIP would create undue competitive, latency and fairness concerns. In particular, if there are latencies in receiving or processing data from other markets, the resulting calculations could be delayed or inaccurate; similarly, if there are latencies in an intermarket linkage or a linkage is not working properly, one or more market centers may be unable to receive timely notice from the calculating market center. While latencies cannot be eliminated, having the SIP perform the calculation will at least assure that all participants are being treated equally, and that no market center is held liable for errors in the calculation.

There are other logistical issues that would need to be resolved before market centers could implement a circuit breaker approach. For example:

- Short orders on the book when the restrictions take effect: How would market centers treat short orders that were legitimate when entered, but remained unexecuted at the time the restriction took effect?
- Erroneous trades: If the trade or series of trades that triggers the circuit is subsequently determined by the exchange(s) in question to be clearly erroneous and is therefore nullified, will “normal” trading resume?
- Circuit Breaker Levels: Do differently priced stocks warrant different circuit breaker levels? How would a subsequent intra-day price increase be treated? How would news situations be handled?

IV. Targeted exemptions are essential

We strongly reiterate the concern, also stressed in our June 2009 letter, that the alternative uptick rule should not be adopted without all necessary exemptions. These include not only those that were formerly contained in Securities Exchange Act Rule 10a-1, and are explicitly contemplated for inclusion in the amendments to Regulation SHO, but targeted exemptions covering market makers in both equities and options; exchange-traded funds and other exchange-traded products



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(collectively, Exchange Traded Products); and point-in-time matching systems.⁴ What was important for the proposals contained in the Commission's initial release is all the more critical for the alternative uptick rule, in light of its much more restrictive impact once it takes effect. We thus reiterate that instituting any short sale price restriction without all appropriate exemptions would have an adverse impact on market quality, market efficiency and overall liquidity, and would fundamentally impair price discovery. It is also important to note that these exemptions are not new, nor would reviving them create new or novel issues. To the contrary, the Commission would be reinstating exemptions that it had previously carefully considered in light of well-understood market forces and conditions, and determined to be beneficial to the marketplace.

1. Market makers

While market makers would seemingly be able to post offers to sell short, the rule would effectively prohibit a market maker from "hitting a bid" absent exemptive relief, thus depriving the market of liquidity that would otherwise be available. In addition, in markets where the market maker has an affirmative obligation to participate as a seller of last resort, a highly restrictive rule like the alternative uptick rule could, without a market maker exemption, cause the market maker to violate its affirmative obligation. This could be significant in hybrid markets such as the NYSE and NYSE Amex Equities markets, in which the designated market maker ("DMM") is required to conduct auctions at certain points in time in order to reduce unwarranted volatility. Imposing short selling restrictions on DMMs at such times would undermine their ability to perform their market making obligations and dampen volatility, which would seem to be at cross purposes to the objectives of a short selling rule.⁵ In our June 2009 letter we note the conclusion of a recent report by the Technical Committee of the International Organization of Securities Commissions ("IOSCO") that identified market making as among the types of market activity that should be considered for exemption from any restrictive rules on

⁴ Those exceptions include seller's delay in delivery; odd lots; domestic arbitrage; international arbitrage; over-allotments and lay-off sales; VWAP transactions; and riskless principal transactions. See Exchange Act Rel. Nos. 34-60509 (August 17, 2009) and 34-59748 (April 10, 2009) (proposing amendments to Regulation SHO).

⁵ DMMs are also required to trade against odd-lot orders in order to provide liquidity to market participants holding odd-lot positions, and thus should not be subject to short selling restrictions in connection with such sales.



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short selling, since market makers “generally provide benefits to the market and are unlikely to pose risks that will destabilize the market.”⁶

Additionally, and as noted in our June 2009 letter, a market maker exemption is critical for equities as well as options market makers. In the absence of an exemption, options market makers would be unable to efficiently hedge their options positions, which could result in less liquid markets with wider spreads. This could have an adverse effect on both options and equities market quality. The burden on options market makers, in the absence of an exemption would be substantial, particularly with a circuit breaker approach, which introduces uncertainty about when and if a hedge order will be filled.⁷

The Commission has sought comment on the definition of a market maker. While we believe that the definition of a market maker should continue to be relatively broad, in order to avoid inadvertently excluding market participants who are in fact providing the traditional functions of a market maker, we also believe that the definition should include some obligation to the market, either in the form of a quoting requirement or an affirmative obligation.

2. Exchange Traded Products

As discussed in depth in our June 2009 letter, the Commission should provide exemptive relief for Exchange Traded Products. The Commission staff previously granted no-action relief from Rule 10a-1 for such products on the basis that such products are transparent and redeemable, noting significantly that trading in such products “would not appear to be susceptible to the practices that Rule 10a-1 [was] designed to prevent.”⁸ There has been no significant change in

⁶ Consultation Report on the Regulation of Short Selling, Technical Committee of the International Organization of Securities Commissions (March 2009).

⁷ NYSE Euronext is also a signatory to the Options Clearing Corporation’s comment letter to the Commission dated June 22, 2009 (available at <http://www.sec.gov/comments/s7-08-09/s70809-3819.pdf>).

⁸ See, e.g., letter from James A. Brigagliano, Acting Associate Director, SEC Division of Market Regulation, to George H. White, Sullivan & Cromwell, dated July 27, 2006 (no-action relief regarding iPath Exchange Traded Notes); letter from Racquel L. Russell, Branch Chief, SEC Division of Market Regulation, to George T. Simon, Foley & Lardner, dated June 21, 2006 (letter granting no-action relief under Rule 10a-1, Rules 101



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the nature of Exchange Traded Products, or in their impact on the market, that would justify changing their treatment under the alternative uptick rule or other short selling restrictions. As was the case when the staff granted no-action relief, it is critical to efficient trading of these securities that they are not subject to short sale restrictions.

3. Point-in-time matching systems

Since point-in-time matching systems match buying and selling interest at prices between the national best bid and offer, and thus above the NBB, any trades executed in such matching systems would necessarily be compliant. However, for the avoidance of doubt, if the Commission adopts the alternative uptick rule it should codify this position.

V. Implementation

A. Logistical issues

There are a number of logistical issues and questions raised by the alternative uptick rule, regardless of whether it is coupled with a circuit breaker, that will need to be addressed. These include, but are not limited to, the following:

- Handling market orders to sell short: It is unclear how market centers would be required to treat market orders to sell short, which would otherwise be automatically executed at the bid. Should they be rejected back to the sender as non-compliant, or should they, in effect, be converted into limit orders one increment better than the prevailing best bid? If the latter, would market centers be required to post those orders as firm offers under Regulation NMS, and to update the offer as the NBB changes? We note that if market orders to sell short essentially become the best offer pegged one penny better than the national best bid, market participants will likely be able to discern the continued existence of short interest (by watching for a pattern of penny spreads that move up and down as the national best bid moves up and down).

and 102 of Regulation M and Rule 200(g) of Regulation SHO with respect to ETVs, including those that hold physical commodities or foreign-based currency, or that are organized as commodity pools); letter from James A. Brigagliano, Assistant Director, SEC Division of Market Regulation, to Kathleen Moriarty, Carter, Ledyard & Milburn, dated November 17, 2004 (no-action relief for streetTRACKS Gold Trust).



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While transparency of pricing is, of course, a positive thing, our concern is that enabling short sellers to continue to signal their interest in this way could undermine the intent behind the proposed rule.

- Handling marketable limit orders to sell short: As with market orders to sell short, it is also unclear how market centers would be required to handle limit orders to sell short that would otherwise be marketable at the bid in the absence of a restriction.
- Minimum increment for permissible short sales: The proposal does not specify the minimum increment above the bid at which short sales would be permissible. We would recommend that it should be consistent with the minimum pricing increments specified in Rule 612 of Regulation NMS, i.e., \$0.01 for securities priced at or greater than \$1.00 per share and \$0.0001 for securities priced less than \$1.00 per share.
- Latency of quote information: Because of potential latencies with quote updates, market centers should only be required to consider the NBB as published by the SIP when determining a compliant execution price for a short sale order, notwithstanding that a better bid may have been received by a particular market center but not yet disseminated. If a market center were to be bound by unpublished orders that it is nevertheless affirmatively aware of, other market centers that are not aware of the better bid would not be restricted from executing at prices inferior to that unpublished bid, which could result in disparate treatment of similarly situated orders.
- Self-Help Declarations under Regulation NMS: If a market center declares self-help against another market that is at the NBB, would the alternative uptick rule prohibit the market that declares self-help from executing short orders below the published best bid of the non-accessible market? And, assuming that the rule would permit short sales below a non-accessible bid price, what would be the reference price for permissible short sales under the rule?
- Locked and Crossed Markets: How would the alternative uptick rule operate in situations where the markets are crossed (that is, the national best bid is greater than the national best offer) or locked (that is, the national best bid is equal to the national best offer)?



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- Compliance: For the reasons noted in our June 2009 letter, if the Commission adopts any short selling price restriction, it should be enforced through a policies and procedures approach rather than on a trade-by-trade basis.

B. Timing

In view of the programming complexities for the national securities exchanges, SIPs, broker-dealers and vendors associated with the alternative uptick rule, particularly if adopted in conjunction with a circuit breaker approach, we would suggest that unlike the other proposals, a slightly longer time to implement such a change would be appropriate. In the absence of defined parameters, it is difficult to provide a discrete estimate of the time needed. Accordingly, it is critical that the Commission solicit views from all constituents to develop a reasonable and appropriate implementation schedule. We would also urge the Commission to consider establishing a pilot to test the reinstatement of short sale restrictions, as we suggested previously.

VI. Conclusion

NYSE Euronext applauds the Commission for its ongoing leadership and careful consideration of how to properly regulate short sales, and appreciates that none of the options is perfect. Nevertheless, we strongly believe that an always-on bid test is a known commodity (since it was in place for a number of years) and would therefore be easiest to implement and apply. Moreover, we believe it represents the best balance between restrictions and operability, and would therefore promote public confidence without unduly inhibiting legitimate short-selling. An alternative uptick rule, by contrast, would unduly restrict legitimate short-selling to the detriment of the market. In the event that the Commission nonetheless concludes that an alternative tick test is the most appropriate regulatory approach to short selling, it is essential that rule be paired with a circuit breaker approach and appropriate exemptions, so that there is a more appropriate balance between restrictions and operability.

Very truly yours,



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cc: The Hon. Mary Schapiro, Chairman
The Hon. Luis Aguilar, Commissioner
The Hon. Kathleen Casey, Commissioner
The Hon. Troy Paredes, Commissioner
The Hon. Elisse Walter, Commissioner
Mr. James Brigagliano, Co-Director, Division of Trading and Markets
Mr. Daniel Gallagher, Co-Director, Division of Trading and Markets