February 16, 2007

Via Electronic Mail: *rule-comments@sec.gov*

Nancy M. Morris
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: **Comments on Release No. 34-54891; File No. S7-21-06 (Amendments to Regulation SHO and Rule 10a-1); Proposed Rule**

Dear Ms. Morris:

The American Stock Exchange LLC ("Amex" or "Exchange") respectfully submits the following comments with respect to File No. S7-21-06 (Amendments to Regulation SHO and Rule 10a-1; Proposed Rule)[1], in which the Securities and Exchange Commission (the "Commission") proposes to remove restrictions on the execution prices of short sales, as well as prohibiting any self-regulatory organization from having a price test. In addition, the Commission is proposing to amend Regulation SHO to remove the requirement that a broker-dealer mark a sell order of an equity security as "short exempt," if the seller is relying on an exception from a price test.

In preparing these comments, the Exchange not only reviewed the Proposing Release, but we also reviewed the draft summary report on the Regulation SHO Pilot prepared by the Commission's Office of Economic Analysis (the "OEA Staff's Draft Summary Pilot Report") and the transcript of the public roundtable (the "Roundtable Transcript") on the Regulation SHO Pilot (the "Regulation SHO Roundtable") that was held on September 15, 2006 and that focused on the empirical evidence from the Regulation SHO Pilot data. The Regulation SHO Roundtable featured the presentation of the results of three completed studies of the Regulation SHO Pilot data by outside academic researchers and the discussion and comparison of their conclusions with those presented in the OEA Staff's Draft Summary Pilot Report.

In general, the Exchange believes that the Regulation SHO Pilot has been a well-planned and well-conducted experiment with respect to ascertaining the effects of eliminating short sale price tests on selected securities. Consequently, the Exchange is supportive of the main conclusions that arise out of the analysis of the Regulation SHO Pilot data that are well supported by that data. It is difficult, for example, to dispute the

---

[1] Securities Exchange Act Release No. 54891 (December 7, 2006); 71 FR 75068 (December 13, 2006) (the "Proposing Release").

OEA Staff's conclusion that there is little empirical justification for maintaining short sale price test restrictions on large securities. At the same time, however, we would urge the Commission to proceed with caution in extending or extrapolating any such conclusions beyond what the data justify. In particular, we have noted numerous statements in the Proposing Release, the OEA Staff's Draft Summary Pilot Report, and the Roundtable Transcript that suggest that the impact of eliminating short sale price tests may differ between large capitalization and small capitalization securities. Such a differential impact would obviously be of great concern to the Amex, which has a large concentration of small capitalization issuers.

As an example of the aforementioned differential impact, the Proposing Release states that, "OEA found that price test restrictions dampen both transitory and permanent price volatility in smaller securities, while amplifying it in larger securities. With respect to intraday volatility, OEA found that there was an increase in volatility in smaller securities and a decline in volatility in larger securities in the absence of price tests."[2] The Proposing Release further noted that, "While the majority of results do not suggest that removing price test restrictions would harm small securities, this volatility result is a potential concern."[3] The implications of any such increased volatility should be seriously considered from an investor protection perspective.

The Proposing Release further noted that "only one Academic Study examined whether Rule 10a-1 has a different impact on small securities than on large securities and found that the significance of the impact of the removal of Rule 10a-1 at times depended on the size (that is, market capitalization) of the securities examined."[4] That same study suggested "that Rule 10a-1 can have a larger impact on small securities . . . ."[5] The Proposing Release also noted that this particular study "found that the widening of spreads [resulting from the elimination of price test restrictions] was more pronounced for smaller rather than larger securities . . . ."[6] Thus, there are potential market quality considerations and possible higher transaction costs to consider if price test restrictions are removed from smaller securities.

Consequently, the Amex believes that it is premature to remove price tests from smaller securities at this time pending further analysis. We are certainly not suggesting the extension of price tests to additional securities, nor are we stating adamant opposition to the prospect of ultimately removing short sale price tests from small capitalization securities to which they currently apply. We are, however, advocating additional study before such action is taken in connection with small capitalization securities. When the Regulation SHO Pilot terminates on August 6, 2007, there will be more than two years of

---

[2] *See* 71 FR 75073.
[3] *See id*.
[4] *See id*. At 75074.
[5] *See id*.
[6] *See id*.

Regulation SHO Pilot data available for study, and we hope that additional studies by the OEA Staff and/or academic researchers will be forthcoming and will reach a more definitive conclusion than "the evidence regarding the application of price test restrictions to small securities is inconsistent."[7] We also strongly urge that such additional studies consider the effect of additional factors that may be relevant for such small securities, including float and average daily volume.

The Exchange also notes a number of comments from participants in the Regulation SHO Roundtable that would seem supportive of our recommendation to proceed in a cautious and deliberate manner with respect to removing price tests for smaller securities. One panelist noted that "there is little evidence about the small cap stocks at this point"[8] and a suggestion was made to "gradually phase out the rule"[9] with a "gradually expanded list of stocks that are not subject to the tick test . . . ."[10] In addition, one panelist summed up the results of all the panelists' comments as follows: "Clearly, all the panelists suggest getting rid of the pricing restrictions with the possible exception of the smallest stocks."[11] Finally, while noting that nine of the twelve panelists in the Regulation SHO Roundtable explicitly supported removing price test restrictions, the Proposing Release stated that "a few of the nine noted a lack of evidence for removing price test restrictions from small securities."[12]

The Amex also believes that one of the caveats stated by the OEA Staff with respect to its research results provides yet another reason for proceeding cautiously with respect to small securities. Specifically, the OEA Staff's Draft Summary Pilot Report stated that, "It is possible that traders might behave differently if a rule were permanently and completely removed than if it is only temporarily or incompletely removed."[13] That section of the report also suggested that "traders with manipulative intentions might be on good behavior if they believed that heightened scrutiny during the pilot increases their chances of getting caught."[14] The Amex therefore believes that it would be prudent to permanently remove short sale price tests in a phased manner, starting with the larger securities. Then, if specifically supported by additional Regulation SHO Pilot data analysis and if manipulative activity has not surfaced in those securities for which price tests have been permanently removed, then price tests could be permanently removed for small securities as well.

---

7 *See id*.
8 *See* Roundtable Transcript at 117.
9 *See id*. at 119.
10 *See id*.
11 *See id*. at 122.
12 *See* 71 FR 75074.
13 *See* OEA Staff's Draft Summary Pilot Report at 57.
14 *See id*.

Finally, the Commission has asked in the Proposing Release for comment on the question of whether the removal of price tests would lead to benefits such as a reduction in costs associated with systems and surveillance costs. While it is difficult to predict future trading activities and the resultant need for new or different regulatory programs, our best estimate is that there would probably be no material impact on our regulatory costs. Even though staff time and technology resources would no longer be required to monitor compliance with the tick test, surveillance by Amex staff for order marking violations would still be required (assuming that sales would still be required to be marked "short" or "long"). In addition, the absence of a tick test to discourage potential "bear raids" and other manipulative activities could result in the need to devote additional resources to such regulatory programs than is currently the case.

Thank you for this opportunity to submit Amex's comments regarding the Commission's proposal. We would be pleased to provide further information regarding our views if requested.

Very truly yours,

cc: The Hon. Christopher Cox, Chairman
The Hon. Paul S. Atkins, Commissioner
The Hon. Roel C. Campos, Commissioner
The Hon. Annette L. Nazareth, Commissioner
The Hon. Kathleen L. Casey, Commissioner
Erik Sirri, Director, Division of Market Regulation
Robert L.D. Colby, Deputy Director, Division of Market Regulation
James A. Brigagliano, Associate Director for Trading Practices and Processing, Division of Market Regulation
Neal Wolkoff, Chairman and CEO, American Stock Exchange