COALITION OF PRIVATE INVESTMENT COMPANIES

July 21, 2008

The Honorable Christopher Cox
Chairman
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Emergency Order Pursuant To Section 12(k)(2) of the Securities Exchange Act of 1934 Taking Temporary Action to Respond to Market Developments
File No. S7-20-08

Dear Chairman Cox:

The Coalition of Private Investment Companies ("CPIC")[1] and the Managed Funds Association[2] submit the following comments regarding the above-referenced Emergency Order dated July 15, 2008, as amended on July 18, 2008 ("Emergency Order"). The Securities and Exchange Commission ("Commission") issued the Emergency Order for the stated purpose of enhancing investor protections against naked short selling in the securities of Fannie Mae, Freddie Mac, and primary dealers at commercial and investment banks (the "Designated Securities").[3]

As managers of alternative investment vehicles, our members share the Commission's concerns with respect to investor protection and the orderly functioning of markets. We recognize that the financial sector is undergoing an extremely stressful period as a result of extraordinarily difficult fundamental economic conditions. We do not believe that current market prices are a result of a mysterious conspiracy or, more to the point, the inadequacy of current rules related to short selling. For the reasons set forth in this letter, we urge the Commission not extend the Emergency Order beyond the announced expiration date of 11:59 pm on July 29th, 2008, or beyond the current list of Designated Securities. If the Commission wishes to consider further changes in this area, we urge the Commission to do so only after conducting a thorough and careful rulemaking process comparable to the process that led to the adoption of Regulation SHO and Regulation NMS.

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[1] CPIC is a coalition of over 20 private investment companies whose members and associates manage or advise over $120 billion in assets. CPIC's members are diverse in size and in the investment strategies they pursue. CPIC was established in 2005 to assist policy-makers, the media and the public in discussing the private fund industry and its role in the capital markets.

[2] MFA is the voice of the global alternative investment industry. Its members include professionals in hedge funds, funds of funds and managed futures funds. Established in 1991, MFA is the primary source of information for policy makers and the media and the leading advocate for sound business practices and industry growth. MFA members represent the vast majority of the largest hedge fund groups in the world who manage a substantial portion of the approximately $2 trillion invested in absolute return strategies. MFA is headquartered in Washington, D.C., with an office in New York.

[3] Press Release, *SEC Enhances Investor Protections Against Naked Short Selling*, July 15, 2008.

The Emergency Order was issued on July 15, 2008 without notice or comment in reliance on the Commission's authority under Section 12(k)(2) of the Exchange Act.[4] However, while the Commission's Emergency Order states that emergency action is necessary,[5] it provides none of the expected facts or evidence to support the particular action in restraint of short selling activity. For example, the Commission's release does not state whether, prior to the issuance of the Emergency Order, the 19 Designated Securities were on lists of threshold securities maintained by the SROs, whether they are among those with the highest short interest, or whether they were the subject of persistent fails to deliver or abusive naked short sales. As a general matter, we understand that there were no significant issues related to the quality of short sale locates or failures to deliver in the 19 Designated Securities. Indeed, the Designated Securities are among the easiest to borrow names of all stocks currently traded.

Given the absence of any discernible emergency related to short sale rules and mechanics, the basis and motivation behind the Emergency Order may be called into question. The Commission's action to limit short selling activity in these 19 securities already has been criticized as stepping on market scales to protect the stock price of a select group of companies. Ironically, the Emergency Order may itself precipitate a loss of confidence in the price discovery function in the United States capital markets, as market participants fear further government intervention to support the stock price of other market segments under stress.

Although the stated purpose of the Emergency Order is to prevent naked short sales, the Emergency Order will have the effect of discouraging legitimate short sales. Of course, there are always those participants who only support free markets when they ascend and then prefer intervention during price corrections and a return to more rational values. Moreover, the temptation remains for corporate management teams to blame unidentified conspiracies and short selling rules as the cause of poor stock performance, rather than acknowledge poor fundamentals, and in some cases, the impact of their own poor risk management and business and investment decisions. Unfortunately, the Emergency Order gives more comfort to those who fall into that camp than it does to the thousands of market professionals who provide the market with its fundamental transparency and integrity.

The Commission's action here stands in stark contrast to its actions to protect retail investors from abusive short selling practices through the adoption of Regulation SHO[6], which

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[4] That section provides that "[t]he Commission, in an emergency, may by order summarily take such action to alter, supplement, suspend, or impose requirements or restrictions with respect to any matter or action subject to regulation by the Commission...as the Commission determines is necessary in the public interest and for the protection of investors." The criteria for an "emergency" under that section involve circumstances that are extraordinary -- as they should be to justify abandonment of the notice and comment process. *See* Exchange Act Section 12(k)(2), 15 U.S.C. §78*l*(k)(2). We note that in a July 16th interview with CNBC, Chairman Cox described the Emergency Order as "prophylactic."

[5] The Commission concludes that "[a]s a result of . . . recent developments. . . there now exists a substantial threat of sudden and excessive fluctuations of securities prices generally and disruption of the securities markets that could threaten fair and orderly markets."

[6] Regulation SHO requires that, before effecting a short sale in any equity security, a broker-dealer must either have borrowed or arranged to borrow the security or have "reasonable grounds to believe" that the security being shorted

[Footnote continued on next page]

was subject to extensive notice and comment. If it is extended to a broader segment or to all equity securities, it will severely burden and reduce short selling activity, which numerous studies and the SEC itself repeatedly has acknowledged plays a vital role in the securities markets.[7]

The best markets are those that are efficient -- where buyers and sellers interact to express their views and ultimately arrive at the price for a given company's shares, and not where one group of market participants may be hampered by overly burdensome and unnecessary regulatory provisions. Restrictions on short sales distort the fundamentals that drive fair market prices and are, in the long run, counter-productive because they remove liquidity and healthy skepticism from the marketplace.

While the market may be able to absorb the negative consequences of the Emergency Order for a limited number of the world's most liquid stocks for a short period of time, expansion of the Emergency Order to a broader list of stocks, as some have called for, will inflict substantial damage on the U.S. equity markets. This damage would threaten the status of the U.S. equity markets as the worlds' equity markets of choice, and would be welcomed by equity markets in other countries that would gladly take business from the U.S.

The expansion of the Emergency Order to stocks that are less liquid than the Designated Securities would undermine critical market activities. The most direct impact of the Emergency Order is to make it more difficult, expensive, and risky to sell short. Under the Emergency Order, before undertaking a short selling strategy, a market participant must consider in advance the costs and risks of ensuring with 100 percent certainty that enough shares will be available to cover the maximum number of shares that may be sold short throughout the duration of the strategy. Moreover, the market participant must compete for suddenly scarce stock borrow with all of the other market participants who are conservatively borrowing substantial amounts of stock to avoid any risk of violating the rule, and with market participants who can easily squeeze shorts by pulling scarce stock borrow from the market.

[*Footnote continued from previous page*]
can be borrowed so that it can be delivered on the date delivery is due (the "locate requirement"). *See* Rule 203(b) of Regulation SHO. 17 CFR §242.203(b). Except in the case of certain threshold securities that have been subject to persistent delivery failures, there is no requirement that the broker-dealer have borrowed or arranged to borrow the securities in advance of the short sales if the broker-dealer has documented compliance with the locate requirement. The Emergency Order conflicts with Regulation SHO because it requires that no person may effect a short sale in the Designated Securities unless such person or its agent has borrowed or arranged to borrow the security or otherwise has the security.

[7] As Chairman Cox noted in a CNBC interview July 16, 2008, "[t]here should be some parity between going long and going short. We need the shorts in our market in order to balance so we don't have bubbles..." SEC Chairman Cox also stated that "if we're talking about legitimate short selling, ... that's vital to the functioning of our markets. The SEC has taken many steps in recent months to make sure that there is easy exit as well as entry to our markets because we understand that that adds to liquidity, and price discovery depends on getting information quickly to the market." *See* CNBC interview on July 16, 2008, available at http://www.cnbc.com/id/15840232?video=795065904&play=1.

For example, an investor may decide to buy a convertible bond. Convertible bonds are a critical tool available to companies, including distressed companies, seeking to raise capital. Most investors in convertible bonds seek to hedge their market risk by shorting stock to maintain a sufficient "delta" hedge. Operating under the rules of the Emergency Order, a potential convertible bond investor, must not only price the cost of selling short on day one, in a highly stressed and distorted stock borrow market, but must price this cost for the entire duration of the expected holding period for the convertible bond. The stock borrow must be maintained for the entire duration of any short position, and additional short sales must be effected to maintain an appropriate delta hedge as the stock price moves. In this scenario, potential convertible bond investors may refrain from investing and leave distressed companies without an important source of capital.

There are many other examples of the direct and indirect damage that would result from the expansion of the Emergency Rule. The result will be market inefficiency, a reduction in liquidity, and artificially created prices resulting from regulatory burdens on the normal price discovery process.

It is also critical for the Commission to consider the importance of short selling to a wide range of investment strategies. When equity markets experience downturns, it is not uncommon for some to attempt to support prices by restricting short selling. However, as the Commission well knows, short sellers have often been the first to uncover and reveal financial misdeeds at companies, turning over the rocks that many in the market would prefer left untouched, pointing out, on occasion, the emperor has no clothes. Moreover, by taking a contrary position (that is, selling short while the mainstream is buying and covering after the mainstream wishes to sell because it has come to understand adversity facing a company), short sellers dampen volatility and provide liquidity. As a result of the benefits short sellers bring to financial markets, most efforts to restrict short selling thankfully have failed.[8] In situations such as those presented by the current distress facing the financial sector, the role of short sellers is perhaps more critical than ever.

Before attributing the steep declines in the stocks in the financial sector to deficiencies in short selling rules, the Commission should consult with fundamental financial analysts. We believe the Commission will find legitimate questions raised by a broad range of investment professionals about fundamental weakness in the sector and the U.S. housing market. We submit that these questions could be best addressed through better disclosures and greater transparency by issuers in the financial sector.

We urge the Commission to allow the Emergency Order to expire, and to fully study and explore all the potential and unintended consequences of the Emergency Order before taking precipitous actions. If the Commission is inclined to expand the Emergency Order, the Commission should undertake thorough study and rulemaking befitting such a fundamental change.

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[8] *See* http://www.dailyreckoning.com/Issues/2001/110201.html.

We thank you for this opportunity to provide our thoughts. We ask the Commission to carefully consider our suggestions, and we would be happy to discuss them at any time.

Sincerely,

James S. Chanos Chairman Coalition of Private Investment Companies	Richard H. Baker President and Chief Executive Officer Managed Funds Association

cc: The Honorable Paul S. Atkins
SEC Commissioner
The Honorable Kathleen L. Casey
SEC Commissioner
The Honorable Elisse B. Walter
SEC Commissioner
Dr. Erik Sirri, Director
Division of Trading and Markets