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MANAGED FUNDS ASSOCIATION
The Voice of the Global Alternative Investment Industry
WASHINGTON, DC | NEW YORK

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October 1, 2008

Via Electronic Mail: coxc@sec.gov

The Honorable Christopher Cox
Chairman
U.S. Securities and Exchange Commission
101 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, Exchange Act Release Nos. 58591, 58591A, 58592 and 58611

Dear Chairman Cox:

As a follow-up to our September 21st letter to you, Managed Funds Association[1] ("MFA") submits this letter on the Commission's emergency orders, Release Nos. 58591 and 58591A (the "Disclosure Order") and 58592 and 58611 (the "Prohibition Order," and with the Disclosure Order, the "Orders") to provide you with additional market information as you assess market regulation.

First, we would like to express our gratitude for your recent testimony before Congress where you reaffirmed the temporary nature of the Orders, stating that they are intended to be "short-term, limited and focused on the financial sector." Like you, MFA, and its members, remain deeply concerned about the ongoing crisis within the financial markets and support timely and targeted initiatives aimed at preventing this crisis from worsening into a global economic event. We also appreciate the new challenges confronting the Commission, and federal financial regulators, in the wake of Congress' failed attempt to adopt the "Emergency Economic Stabilization Act of 2008."

However, given the negative unintended consequences from the Orders, we hope that this Congressional setback will not result in the Commission extending the Orders. In that regard, we reiterate our request that the Commission not extend either Order beyond its announced expiration date. We also request that the Commission, in the interim, amend the Disclosure Order to provide for non-public disclosure of detailed short positions. To the extent the Commission deems it necessary to extend the Orders, we urge the Commission to amend the Orders to mitigate the significant adverse effects of the current versions as discussed below. We also

1 MFA is the voice of the global alternative investment industry. Its members are professionals in hedge funds, funds of funds and managed futures funds, as well as industry service providers. 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 include 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.

request the Commission extend the market making and derivatives exception provided in the Prohibition Order.

In our September 21st letter, we expressed our immediate concern that the Orders would have the adverse effects of further reducing liquidity, increasing market volatility, and unfairly jeopardizing the proprietary trading strategies of managers, to the detriment of their clients and investors. An analysis of market conditions since the Orders went into effect confirms that the Orders have in fact impaired the fair and orderly function of the equity, options and convertible debt markets, increased volatility and decreased liquidity in our capital markets. More importantly, the Orders appear, to a degree, to have worked against the stated objective of helping restore "equilibrium' to financial markets. In that regard, we would like to take this opportunity to provide the Commission with some recommendations that we believe may enable the Commission to accomplish its underlying objectives while addressing some of our concerns.

Request for Amendments

Disclosure of detailed shorting positions should not be publicly disclosed

MFA continues to urge the Commission not to make public any information on shorting activity obtained pursuant to the Disclosure Order. MFA understands the Commission's desire for additional information about short selling activities and believes these concerns can be addressed adequately through disclosure to the Commission and do not necessitate public disclosure of detailed short positions.

We reiterate the concerns we raised in our September 21st letter with respect to the Disclosure Order having the perverse effect of increasing market volatility, being potentially misleading to the public, and causing irreversible harm to the proprietary trading strategies of money managers and harming fund investors, such as pensions, endowments and foundations.

In addition, we are concerned that the Disclosure Order is having the effect of reducing liquidity and impeding much needed capital-raising. Pension, endowment and foundation investors have indicated that due to headline risk, they will need to withdraw their investments from investment vehicles engaged in short selling if the Commission requires public disclosure of short trading positions. The net effect could be that billions of dollars will be withdrawn from our capital markets at a time when our markets need liquidity and added capital more than ever, and only to be reinvested once the market turmoil is over.

Some issuers have also stated that once they find out which firms have been shorting their securities, that they will cease communications with analysts of those firms and exclude them from information sessions. As the Commission recognizes, short selling serves an important role in our financial markets by contributing to price efficiency and adding liquidity to the markets. We are concerned that the public disclosure of detailed short positions will have long lasting negative effects on our markets by having a chilling effect on the information and transparency provided by issuers, as well as subjecting firms to possible retaliation by issuers.

We are also concerned that public disclosure could incentivize market participants to act in ways that could actually further increase market instability. There is a real danger that as a result of the Disclosure Order managers will halt trading and/or liquidate portfolios to prevent others from exploiting their positions. Some market participants may seek to squeeze publicly known short positions, and others may unwind the long and short side of hedged positions to comply with the Orders or to protect sensitive information from competitors. Companies whose stock is shorted may be disadvantaged, as a short sale in place as a hedge could be misinterpreted by the investing public as a negative view on the companies' prospects. Shorting of certain stocks may actually increase as other market participants follow firms' widely publicized short positions.

We believe that the detailed disclosure required under the Disclosure Order if made public at any point in time will still engender the adverse market consequences outlined in our September 21st letter and this letter, and will still fully permit other market participants to unfairly reverse engineer the proprietary trading strategies of a money manager. Efforts to deter and detect fraud could be better addressed through routine private filings with the Commission. In the absence of any demonstrated policy reason for public disclosure of Form SH, we urge the Commission to amend the Disclosure Order to provide for Form SH to be disclosed only to the Commission, and for the Commission to keep such information strictly confidential. To the extent that the Commission believes public disclosure of short interest would provide some benefit, the Commission could amend the Disclosure Order to provide for public disclosure only of aggregated short positions that are not specific to individual market participants.

Exception from Prohibition Order for bona fide hedging transactions

The Prohibition Order has undermined the bona fide hedging strategies that are a critical risk management tool of investors and enable investors to make investments on the long side of the market. Most investors in convertible bonds and convertible preferred securities ("Convertibles") seek to hedge their market risk by shorting stock to maintain a sufficient "delta" hedge. These strategies enable companies to raise capital less expensively than they would in traditional debt markets, and serve as a stabilizing force in the market. Under these strategies, when stocks go up, owners of Convertibles sell short to hedge their exposure, and when stocks go down, they buy to cover short positions and limit volatility to the down side. Similarly, the same dynamic occurs with respect to volatility strategies and option volatility positions, where participants attempt to cover short when prices fall and sell short when prices rise.

The estimated year to date issuance of Convertibles is $60 billion, with about $39 billion issued by financial companies.[2] The Prohibition Order has effectively frozen this source of capital for financial companies, because investors refuse to purchase Convertibles and provide financing to these companies without the ability to hedge these investments. While the Prohibition Order was meant to build confidence and allow for capital-raising, it has had the perverse effect of shutting down an important avenue for companies to raise capital by not providing an exemption for bona fide hedging transactions. In addition, the Prohibition Order has destabilized the option value of Convertibles by causing a significant decline in the option value of Convertibles issued by financial services companies—in some cases by one-third or more since the Prohibition Order became effective. As a consequence, the Prohibition Order may have actually made it harder for financial companies to raise capital as institutional investors are likely to take the value of a financial firm's securities and Convertibles into consideration as they assess the value and strength of the company.

2 Short Sale Ban Wallops Convertible-Bond Market, WSJ, September 26, 2008.

The impact of the Prohibition Order can also be measured by its effect on the market quality of the options markets. Below is a short summary of the impact on options markets, followed by a table illustrating that impact:

- In more liquid options (ones that traded more than 100,000 contracts in August), that were put on the ban list, average spreads more than tripled.
- In less liquid options (ones that traded less than 100,000 contracts in August), that were put on the ban list, average spreads almost quadrupled.
- Even in names not on the ban list, spreads are up 50% in more liquid options, and have doubled in less liquid options.

SEC Short List	Aug > 100K contracts	Symbols	Sep 1 to 18	Sep 19 to 22	% Increase
TRUE	TRUE	36	0.27	0.85	212%
TRUE	FALSE	101	0.37	1.42	285%
FALSE	TRUE	252	0.27	0.42	56%
FALSE	FALSE	1,364	0.34	0.68	103%

In light of the adverse consequences from investors being unable to protect against risk from their long investments and the lack of market risk posed by bona fide hedging, we urge that the Commission amend the Prohibition Order to allow for bona fide hedging transactions. We also note that other foreign regulators have provided such an exemption from their short selling prohibitions in order to avoid the unintended consequences discussed and to allow for capital-raising. We request that the Commission amend the Prohibition Order to provide the following exception from the prohibition on short selling Included Financial Firms:

> The requirements of the Order shall not apply to any short sale in any publicly traded security of an Included Financial Firm effected by an institutional money manager subject to the requirements of SEC Release Nos. 58591 or 58591A as part of its bona fide hedging activities related directly to hedging long exposure to such Included Financial Firm arising from (i) options, warrants, convertible securities, index products or other derivatives held by such institutional money manager or (ii) equity interests held by such institutional money manager in the target of an announced acquisition by such Included Financial Firm.

To the extent that the Commission believes a broad-based bona fide hedging exemption would be inconsistent with the objectives of restoring "equilibrium to markets," we request the Commission consider at the very least a narrowly tailored exemption for bona fide hedging activity relating to the purchase of convertible securities and equity derivatives.

<u>Materiality Standards for Short Sale Prohibition List</u>

The SEC understandably delegated to the exchanges authority to select the individual financial institutions with securities covered by the Prohibition Order. Unfortunately, the Prohibition Order fails to include a materiality standard for determining whether a company is a "financial firm" for purposes of the Prohibition Order. As a result, many issuers who have never held themselves out to be and should not be considered a "Financial Firm" are being added to the list of financial firms prohibited from being sold short. Some examples include: IBM, CVS, U-Haul, Zale Corp., AutoNation and Ford, as well as real estate holding companies. Attachment A provides a more extensive list of examples. Moreover, additions to the list are being made with little or no advance notice. This degree of moment-to-moment unpredictability is not appropriate for fundamental market rules, imposes significant burdens in complying with the rules and is detrimental to the health of our financial markets. Markets thrive on predictable rules. Consequentially, the Prohibition Order is becoming a de facto ban on short selling.[3]

We urge the Commission to adopt a materiality standard in determining whether a company meets the criteria of being a financial firm covered by the Prohibition Order. In particular, the Commission should consider, in assessing if the company meets the stated purpose of the Prohibition Order, the core business function of the company, and whether in conducting its core business the company depends upon the confidence of its trading counterparties.

Recommendations

To address the Commission's desire for increased information on short selling, we recommend the Commission consider quarterly, non-public reporting of end of quarter short positions of institutional investors and broker-dealers.

To address the Commission's concern over sudden and unexplained price movements in securities, we recommend the Commission consider implementing circuit breakers for individual securities when they trade up or down by a certain percentage from the previous day's close.

Conclusion

MFA shares the Commission's deep concerns about the crisis in the global financial markets and strongly supports efforts to prevent, detect and punish manipulative conduct. As witnessed this past week, however, the Orders have not prevented price declines of financial institutions, volatility in the securities of these firms, or the failure of a financial institution. The Orders have, however, increased volatility, reduced liquidity, abruptly halted capital-raising through the issuance of Convertibles, impaired investors' ability to manage risk, and negatively affected market quality in the equity, options and convertible debt markets.

We believe the Orders have not achieved any benefit, but have exacerbated fluctuations in the affected securities' prices and disrupted the functioning of fair, orderly markets. MFA urges the Commission not to extend the Orders beyond its announced expiration date and to amend the Disclosure Order to require non-public disclosure of detailed short positions. In the event the Commission chooses to extend the Orders, we request the Commission amend the Prohibition Order to include an exemption for bona fide hedging transactions and a materiality standard in determining whether a company is a "financial firm" for purposes of the Order. We believe these amendments will help mitigate the discussed adverse consequences of the Orders.

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3 We note that as of the afternoon of September 29, there were almost 1,000 securities on the Prohibition List.

Again, we appreciate the opportunity to provide comments to the Commission on these important issues and to offer our recommendations. If we can provide further information or be of assistance to the Commission as it considers these comments or other matters related to the Orders, please do not hesitate to contact us at (202) 367-1140.

Respectfully submitted,

Richard H. Baker
President and CEO

cc:

The Honorable Luis A. Aguilar
SEC Commissioner
The Honorable Kathleen L. Casey
SEC Commissioner
The Honorable Troy A. Paredes
SEC Commissioner
The Honorable Elisse B. Walter
SEC Commissioner

Attachment A

Ticker	Name	Economic Sector	Industry	Sub-Industry
F	Ford Motor Co.	Consumer Discretionary	Automobiles	Automobile Manufacturers
GM	General Motors Corporation	Consumer Discretionary	Automobiles	Automobile Manufacturers
HRB	H&R Block, Inc.	Consumer Discretionary	Diversified Consumer Services	Specialized Consumer Services
MORN	Morningstar Inc.	Consumer Discretionary	Media	Publishing
IBM	International Business Machines Corporation	Information Technology	Computers & Peripherals	Computer Hardware
NEWT	Newtek Business Services Inc.	Information Technology	IT Services	Data Processing & Outsourced
AET	Aetna Inc.	Health Care	Health Care Providers & Services	Managed Health Care
AGP	AMERIGROUP Corp.	Health Care	Health Care Providers & Services	Managed Health Care
CI	CIGNA Corp.	Health Care	Health Care Providers & Services	Managed Health Care
CNC	Centene Corp.	Health Care	Health Care Providers & Services	Managed Health Care
CRVL	CorVel Corp.	Health Care	Health Care Providers & Services	Health Care Services
CVH	Coventry Health Care Inc.	Health Care	Health Care Providers & Services	Managed Health Care
ESRX	Express Scripts Inc.	Health Care	Health Care Providers & Services	Managed Health Care
GTS	Triple-S Mgmt Corporation	Health Care	Health Care Providers & Services	Managed Health Care
HNT	Health Net Inc.	Health Care	Health Care Providers & Services	Managed Health Care
HS	HealthSpring Inc.	Health Care	Health Care Providers & Services	Managed Health Care
HUM	Humana Inc.	Health Care	Health Care Providers & Services	Managed Health Care
MHS	Medco Health Solutions, Inc.	Health Care	Health Care Providers & Services	Health Care Services
MOH	Molina Healthcare Inc.	Health Care	Health Care Providers & Services	Managed Health Care
UAM	Universal American Corp	Health Care	Health Care Providers & Services	Managed Health Care
UNH	Unitedhealth Group, Inc.	Health Care	Health Care Providers & Services	Managed Health Care
WCG	WellCare Health Plans, Inc.	Health Care	Health Care Providers & Services	Managed Health Care
WLP	WellPoint Inc.	Health Care	Health Care Providers & Services	Managed Health Care
GE	General Electric Co.	Industrials	Industrial Conglomerates	Industrial Conglomerates
ITC	ITC Holdings Corp.	Utilities	Electric Utilities	Electric Utilities
ABR	Arbor Realty Trust, Inc	Financials	Real Estate Investment Trusts	Mortgage REITs
AMB	AMB Property Corp.	Financials	Real Estate Investment Trusts	Industrial REITs
BEE	Strategic Hotels & Resorts, Inc	Financials	Real Estate Investment Trusts	Specialized REITs
DDR	Developers Diversified Realty Corporation	Financials	Real Estate Investment Trusts	Retail REITs
GGP	General Growth Properties Inc.	Financials	Real Estate Investment Trusts	Retail REITs
LXP	Lexington Realty Trust	Financials	Real Estate Investment Trusts	Office REITs

Attachment A

MFA	MFA Mortgage Investments, Inc	Financials	Real Estate Investment Trusts	Mortgage REITs
PLD	ProLogis	Financials	Real Estate Investment Trusts	Industrial REITs
RKH	Regional Bank HLDRS	N/A	N/A	N/A

McElveen, Josephine

From: Nagesh, Ammani
Sent: Wednesday, October 01, 2008 2:05 PM
To: CHAIRMANOFFICE
Subject: FW: MFA Letter on Emergency Orders
Attachments: MFA Letter to SEC.10.1.08.doc; Attachment A - Selected Companies on Short Sale Prohibition List.doc

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From: Newell, Matthew [mailto:matthew@managedfunds.org]
Sent: Wednesday, October 01, 2008 1:48 PM
To: Cox, Christopher
Cc: aguilarl@sec.gov; Casey, Kathleen; paradest@sec.gov; Walter, Elisse; Baker, Richard H.; Hollingsworth, Roger; Charon, Marc; Gaine, Jack
Subject: MFA Letter on Emergency Orders

Dear Chairman Cox,

On behalf of Managed Funds Association, please find attached our comments relating to the recent short selling Emergency Orders. We would be happy to discuss any of these matters further with the Commission.

Kind Regards,
Matt

Matthew Newell | *Legal Counsel* | matthew@managedfunds.org
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