September 22, 2009

The Honorable Mary L. Schapiro, Chairman  
The Honorable Kathleen L. Casey, Commissioner  
The Honorable Elisse B. Walter, Commissioner  
The Honorable Luis A. Aguilar, Commissioner  
The Honorable Troy A. Paredes, Commissioner  
United States Securities and Exchange Commission  
100 F. Street, NE  
Washington, D.C. 20549-0609

Re: Securities and Exchange Commission Securities Lending and Short Sale Roundtable, File Number 4-590.

Dear Chairman and Commissioners:

   International Bancshares Corporation ("IBC") (Nasdaq: IBOC) is a well capitalized $11.4 billion multi-bank financial holding company headquartered in Laredo, Texas, with more than 280 facilities and more than 440 ATMs serving 104 communities in Texas and Oklahoma. Dennis Nixon, President, Chief Executive Officer and Chairman of the Board of IBC has been selected to participate on the Securities and Exchange Commission’s (the “Commission”) Securities Lending and Short Sale Roundtable (the “Roundtable”) panel discussing the implementation of a pre-borrowing or hard locate rule. This letter is a supplement to Mr. Nixon’s opening remarks and serves as IBC’s written statement. In short, IBC firmly believes that short traders should be required to pre-borrow shares before engaging in a short trade and should have parallel disclosure obligations to long traders.

   This year IBC has been (i) ranked the number one Hispanic-owned financial institution by the Hispanic Business Magazine for the fourth consecutive year, (ii) ranked 11th by the ABA Banking Journal’s 2009 rankings of Banking’s Top Performers, (iii) ranked 18th on Bank Director Magazine’s Bank Performance Scorecard of Top 150 Banks and Thrifts in the United States, and (iv) selected as a participant on the FDIC’s community bank advisory committee. While IBC’s banking operations have not been immune from the effects of the economic downturn, it has been one of the best performers among its peers, experiencing a record of over 136 consecutive quarters of continuous profitability. Having experienced economic downturns in the past in Texas, such as the 1980 oil bust, IBC expected an impact to its stock price given the financial crisis. However, no one expected that short sellers would be able to severely detach IBC’s fundamental value from its trading price.

   IBC has spent the last six months with a team of professionals in educating, investigating and taking action to prevent what appears to be manipulative short selling in IBC stock. IBC has met personally with the Commission, ABA, FINRA, the Nasdaq and several members of Congress to explain the negative effect short sellers can have on financial institutions. Additionally, IBC submitted a twenty-two page comment letter dated June 9, 2009 (attached

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1 Mr. Nixon’s biography is attached hereto as Exhibit A.
hereto as Exhibit B) on reinstating the uptick rule which called for the Commission to (1) vigorously enforce current short selling rules; (2) institute a "pre-borrow" requirement for short sale transactions; (3) promulgate disclosure rules for short sellers which mirror those obligations for long positions; (4) investigate the impact of the market maker exemption from the "locate" rule exemption under Regulation SHO in connection with the potential abuse of the clearing/settlement process creating naked short positions; and (5) promulgate rules which would require brokers to allocate lent stocks to specific margin account holders and disclose to the margin account holder of a loss of voting for those shares. In a supplemental comment letter dated June 17, 2009 (attached hereto as Exhibit C), IBC urged the Commission to promulgate rules to address the lack of reporting and transparency in which short sellers operate. IBC has also submitted letters to bank regulators requesting their investigation into how short sellers may be violating certain bank regulatory laws. All of these efforts have involved substantial expense of both time and money to better protect IBC’s shareholders, depositors and the communities it serves.

Since the beginning of the year, IBC’s short volume has increased to a high of over 11 million shares, an increase of 891%. At its peak, short sellers represented over 21% of IBC’s generally accepted float, and drove IBC’s stock price from over $24, to a low of $6.55 in a matter of months. Coincidentally, on the same day IBC’s stock price reached its all-time low, a negative analyst report/blog posting was issued by a well-known short seller encouraging other short sellers to short IBC. That trading day was IBC’s all-time second largest day of trading volume. Ironically, that same day IBC saw more buyers for its common stock than sellers, but its stock price still dropped to $6.55. Subsequently, another blog was posted, again, coincidentally, on IBC’s third all-time largest trading volume day. As if two coincidences were not enough, Nasdaq has since informed IBC that it appears that a group of short sellers curiously took their positions in IBC shortly before the first blog entry and have remained there since, which is an abnormally long time. Attached as Exhibit D and E are two charts which show the dramatic impact the short sellers have had on IBC.

IBC believes short sellers provide little value to the market outside of legitimate market making activities. The current rules allow for naked shorting of a stock within a three day window, but only classify the trade as "naked" once there is a failure to deliver. IBC believes a true "naked" short position is created when a short seller sells a stock without first borrowing the security. IBC has yet to be convinced why the current three-day delivery time should be allowed. IBC believes the Commission should modify Regulation SHO, Rule 203 and Rule 204T to require that all short sales be "pre-borrowed."

Regulation SHO, Rule 203, requires that short sellers either (i) have borrowed ("pre-borrowed") or entered into a bona fide arrangement to borrow the security, or (ii) have reasonable grounds to believe the security can be borrowed before the settlement date. The Commission has defined a "naked" short sale to mean when a security is not delivered on settlement date. However, IBC believes a true "naked" short position is created when a short seller sells a stock without first borrowing the security. The current rules allow for a true naked short if a seller can conjure up "reasonable grounds" for not pre-borrowing the stock. By documenting a "reasonable ground,” the

short seller is allowed to have a naked short for three days. The Commission does not consider these short-term naked shorts a problem until the fourth day, if the stock is not delivered. On the fourth day, the Commission equates a failure to deliver to the creation of a “naked” short position.

IBC believes that the three day location window provides a loophole for manipulative short selling activity. For three days, a true naked short sale goes undetected and the short seller has a window in which they can add extra downward momentum on a stock, because without being forced to borrow the shares first, traders can short a limitless amount of stock. Additionally, pre-borrowing eliminates the probability that a stock lender will lend out the same shares to several different traders. While the current rules reduce the timeframe for short sellers to engage in manipulative strategies before being identified, IBC still believes that manipulative strategies, used prior to the more stringent rules, can still take place, albeit now in a shorter timeframe.

Furthermore, IBC believes that the current three day window allows for related third parties to “cycle” their short interest positions within the window and prevent a failure to deliver on the fourth day. This means that the reports on failure to delivers could be understated and large naked short positions may still exist. IBC’s stock has seen a significant rise in the trading volume of its common stock. Since January 29, 2009, IBC’s trading volume has been abnormally high. IBC was listed in the S&P Midcap 400 on February 2, 2009, but this volume has remained higher for an abnormally longer period of time than what firms typically experience upon being listed. Since the beginning of the year, IBC’s short interest has grown 860% to over 21% of IBC’s recognized float. Exhibit C shows the dramatic shift in IBC’s volume and short interest trend. IBC believes that this increase in volume may represent evidence of the “cycling” of short positions between related parties, and IBC is advocating greater transparency into short sellers and their interests so that the market can identify whether sudden volume changes are based on market fundamentals or short seller manipulation.

Lastly, IBC sees no need for any window to locate shares given the significant impact of technology on the market, such as the dematerialization of stock certificates. Since certificates are moved electronically instead of physically, short sellers are able to locate shares immediately prior to engaging in a short position. While there may be an opportunity cost associated with searching for the security, that cost is likely small. Thus, a pre-borrowing requirement will not reduce efficiencies in the market. IBC does, however, recognize that there should be an exception for market makers, but only with clear guidance on legitimate market making activities provided by the Commission. IBC asks that the Commission re-examine the three day window under Rule 203 and 204T, and promulgate a “pre-borrowing” requirement for all short sales.

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3 See Liz Moyer, Curbing Short-Selling Abuse, FORBES (July 15, 2008).
4 This observation was made by an official at NASDAQ, Frank Hatheway, Senior Vice President and Chief Economist on May 27, 2009.
EXHIBIT A
DENNIS NIXON BIOGRAPHY
As the principal architect behind the unprecedented growth of International Bancshares Corporation and International Bank of Commerce, Dennis E. Nixon is widely recognized as one of the nation's leading banking authorities and executives. Since joining IBC in 1975, Nixon has been instrumental in International Bancshares Corporation's ranking as the largest minority-owned bank organization in the continental United States. Nixon's knowledge in all areas of banking was pivotal in the development of IBC's extensive acquisition and expansion efforts. The IBC family of banks has assets of $11.4 billion with 280 full-service branches, and more than 440 ATMs, throughout 104 communities in Texas and Oklahoma.

IBC's strategic development designed by Nixon and his leadership team is best summed up in the company's credo, "We Do More." The bank's outstanding growth and consistent performance with Nixon at the helm is what sets it apart from other institutions. An example of IBC's growth is the 7-day full service in-store banking facilities at grocery stores such as H-E-B., Wal-Mart, Kroger, Randall's and shopping malls. Nixon's vision is to expand by providing the convenience of banking where people shop.

Internationally, Nixon was instrumental in the passage of the North American Free Trade Agreement. In May of 2008, IBC was recognized with the United States-Mexico Chamber of Commerce's Good Neighbor Award for the bank's contribution to the passage of NAFTA, on its 15th anniversary. Nixon has also been actively involved in its financial development, which has occurred between the U.S. and Mexico.

Nixon's approach to banking, in which all customers large and small are cherished, is that which he describes as "local." This unorthodox business environment has been achieved through years of building outstanding rapport with the communities IBC serves. This is clearly visible as he is avidly involved in the community and gives of his time willingly. Nixon promotes generosity and volunteerism from his employees by encouraging them to participate in charitable events. Through his selfless example, almost 70 percent of IBC employees participate in civic activities with various non-profit organizations. This commitment resulted in IBC receiving the Governor's Volunteer Award for the State of Texas.

For his outstanding generosity, United Way honored Nixon with its acclaimed Platinum Corazón Award. His myriad of civic involvements, awards and recognitions have been on a national and international level. Other recognitions include the Junior Achievement Business Hall of Fame Award, the Paul Harris Fellow Award given by Rotary International for outstanding community service, and the Eleanor Roosevelt Humanities Award given by the State of Israel for outstanding services to humanity. In 2006, Dennis Nixon was inducted into the prestigious Texas Business Hall of Fame. In 2007, he was elected to serve on the board of directors of the United States Chamber of Commerce, and in 2008 he received the International Citizen Award from the World Affairs Council of San Antonio. Recently, he was selected to be the recipient of the Mr. South Texas 2010 honor by the Washington's Birthday Celebration Association.

Other civic activities that Nixon participates in include the American Heart Association, the American Cancer Society, the Boys and Girls Club of Laredo, United Way of Laredo and other similar organizations to improve the health and quality of life for citizens of Laredo and South Texas. Nixon is Past President of the Laredo Chamber of Commerce as well as the Laredo Development Foundation. He is also a founding member of the Association of South Texas Communities and the Alliance for Security and Trade, bipartisan organizations for the betterment of South Texas. Nixon currently serves on the Board of Visitors of M.D. Anderson Cancer Center in Houston, TX.

Nixon is a graduate of the University of Texas. He is married to Elma "Bavi" H. Nixon, and has three children: Denise Nixon Bunk, Jonathan A. Nixon and Kristina E. Nixon Netzer; and four grandchildren, Samantha Rose Bunk, Charles Davis Bunk, Jonathan Dennis Nixon, and Sebastian Rolf Nixon.
June 9, 2009

The Honorable Mary L. Schapiro, Chairman
The Honorable Kathleen L. Casey, Commissioner
The Honorable Elisse B. Walter, Commissioner
The Honorable Luis A. Aguilar, Commissioner
The Honorable Troy A. Paredes, Commissioner
United States Securities and Exchange Commission
100 F. Street, NE
Washington, D.C. 20549-0609

Re: Securities and Exchange Commission Release No. 34-59748; File No. S7-08-09 (the "Proposed SHO Amendments")

Dear Chairman and Commissioners:

International Bancshares Corporation ("IBC"), respectfully submits this letter (the "Letter") in response to the above release. IBC fully supports the Commission's proposed rule to amend Regulation SHO under the Exchange Act of 1934 (the "Exchange Act") to adopt a modified uptick rule based on the National Best Bid, and adopt a circuit breaker rule that would halt any increases in short positions in a particular security that suffers a ten percent (10%) intraday decline. In addition to the Commission's call for comments on reinstating an uptick rule and creating circuit breakers, IBC also respectfully asks the Commission to: (1) vigorously enforce the current short selling rules; (2) institute a "pre-borrow" requirement for short sale transactions, or at the very least, make Rule 204T permanent; (3) promulgate disclosure rules for short sellers which mirror those obligations for long positions, (4) investigate the impact of the market maker exemption from the "locate" rule exemption under Regulation SHO in connection with the potential abuse of the clearing/settlement process creating naked short positions, and (5) promulgate rules which would require brokers to allocate lent stocks to specific margin account holders and disclose to the margin account holder of a loss of voting for those shares.

INTRODUCTION

In July 2007, the Commission eliminated Rule 10a-1 under the Exchange Act (the "Uptick Rule"). The elimination of the Uptick Rule came after a pilot program, temporarily suspending the Uptick Rule for certain securities (the "Pilot Program"). The Pilot Program allowed the

1 (NASDAQ: IBOC) is a $12.4 billion multi-bank financial holding company headquartered in Laredo, Texas, with over 265 facilities and over 420 ATMs serving more than 101 communities in Texas and Oklahoma.
Commission’s Office of Economic Analysis ("OEA") to gather and examine market and trading data from May 2, 2005 to August 6, 2007. Additionally, several academics released studies analyzing the data from the Pilot Program and its impact on the markets. The authors of these reports were invited by the Commission to participate in a public roundtable on the Pilot Program (the "Pilot Roundtable"). Based on the aforementioned reports, and the Pilot Roundtable, the Commission eliminated the Uptick Rule.

Since the Uptick Rule’s elimination, the market has experienced extreme volatility and steep price declines in certain financial stocks, including IBC, all significantly due in part to the actions of short sellers. One trader noted that the removal of the Uptick Rule was “an aphrodisiac for volatility.” The actions of these short sellers have eroded investor confidence, put market fundamentals out of balance and have disrupted the integrity and stability of our financial system. This has prompted investors to request that the Commission reinstate the Uptick Rule, including issuers, academics and members of Congress, culminating in over 4,000 requests received by the Commission’s Office of Investor Education and Advocacy.

On April 8, 2009, the Commission had an open meeting to discuss whether to propose reinstating the Uptick Rule, or some version thereof. In a unanimous decision, the Commission voted to release the Proposed SHO Amendments and seek public comment on whether short sale price restrictions, circuit breaker restrictions or some combination thereof should be imposed.

DISCUSSION

IBC believes that short sellers provide no benefit to the marketplace and in fact create a Las Vegas style gambling environment. Therefore, short sales should be prohibited in their entirety, except for certain “bona fide market making activities” by market makers pursuant to specific guidance promulgated by the Commission. However, recognizing that the Commission has long held the view that short selling provides the market with important benefits, IBC strongly supports the Commission’s proposal to institute a form of the Uptick Rule.

IBC is a well capitalized $12.4 billion multi-bank financial holding company headquartered in Laredo, Texas, with over 265 facilities and over 420 ATMs serving more than 101 communities in Texas and Oklahoma. On December 23, 2008, IBC took TARP funds at the federal government’s request. IBC chose to participate in the Troubled Asset Relief Program ("TARP"), through the Capital Purchase Program ("CPP"), even though IBC was well capitalized. Since the

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4 Office of Economic Analysis, Securities and Exchange Commission, Economic Analysis of the Short Sale Price Restrictions under Regulation SHO Pilot, (September 14, 2006).
7 See Uptick Elimination Release.
8 Aaron Lucchetti and Peter A. McKay, Rule Change Ticks Off Some Traders, THE WALL STREET JOURNAL (August 14, 2007).
9 See id. at 9 (noting that the Commission believes that short selling adds market liquidity and pricing efficiency).
CPP was designed to only be offered to sound financial institutions with solid regulatory ratings and was encouraged by the bank regulators and the U.S. Department of the Treasury (the "Treasury"). IBC deemed it prudent to participate and issued $216 million of preferred stock to the Treasury. Since that time, IBC has experienced an artificial disconnect between IBC's stock price and market fundamentals, due in significant part to speculative short sellers.

IBC has experienced "economically significant" harm since the elimination of the Uptick Rule. IBC saw a 188% increase in short interest from February 13, 2009 to March 31, 2009, resulting in a stock price decline of 54.31% during that time. Total short interest in IBC exceeded 20% of IBC's recognized float at the March 31, 2009 report date, and has remained above 20% since the March 31st report. During this time, the overall stock market experienced a 10.8% increase in short interest on the NYSE, a 4.4% increase over the same period on the NASDAQ, and the financial sector, as represented by the S&P 500 Financial Sector Index, experienced a 4.65% stock price decline.

On March 23, 2009, IBC was the victim of a misleading short seller's analyst report, which was used to negatively impact IBC's stock price and encouraged other short sellers to short sell IBC stock. On that same day, IBC saw more buyers for its common stock than sellers; however, its stock price dropped 12.58% to $6.55, its 52-week low. If IBC's shares were not being manipulated via short sellers, normal supply and demand principles would have dictated a higher, rather than lower, stock price. A second misleading report by the same analyst was published on April 30, 2009. Suspiciously, IBC experienced its second and third highest day of trading volume of all-time on the days the two misleading reports were issued. The only higher trading volume day was the date in which institutional buyers purchased shares ahead of IBC's listing in the S&P Midcap 400 Index. All of these actions, which have served to artificially drive down the stock price of IBC, have led to long term investors and depositors questioning the financial stability of IBC. NASDAQ assisted IBC in reporting the misleading short trader reports to FINRA and an investigation is pending. IBC currently has very minimal legitimate analyst coverage, and IBC believes this lack of coverage combined with its relatively smaller market cap and smaller number of shares outstanding make it a prime target for manipulative short selling strategies, such as the misleading March 23rd and April 30th short seller analyst reports.

IBC's recent stock price volatility does not reflect the market fundamentals underlying IBC's business. In February 2009, the Bank Director Magazine ranked IBC 18th in its Bank Performance Scorecard of Top 150 Banks and Thrifts in the United States. In 2008, the Hispanic Business Magazine recognized IBC as the number one Hispanic-owned financial institution in the country. Standard & Poor's rated IBC in the 94th percentile in its Investability Quotient.

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11 As reported on www.nasdaq.com (last visited May 27, 2009).
12 March 24, 2009 Reuter's article, "Short Stocks: Bets Build Against Banks, Tech."
Percentile on March 28, 2009; which describes how good a company’s medium to long-term
return potential is relative to the entire S&P. However, this same report noted that IBC’s
technical evaluation was bearish, ranking 6 out of 100 (100 indicates a bullish indicator). This
report exemplifies that the stock trading price of the company was disconnected from IBC’s
fundamental value. IBC believes this disconnect was due in significant part to speculative short
sellers.

Historically, IBC has had an ongoing stock repurchase program. IBC was required to terminate
the stock repurchase program in connection with participating in TARP. IBC believes the
inability to repurchase its common stock made it more vulnerable to the short traders’ efforts to
drive down the stock price.

On March 27, 2009, IBC sought consent from the Treasury to use some or all of its regular
dividend funds to repurchase common stock. In the consent request, IBC explained how its
stock price had fallen precipitously in connection with the steep rise in short-interest trading
since IBC became a TARP participant. IBC further explained that the depressed stock price
greatly impaired IBC’s capital raising ability, created reputational damage and had other untold
collateral consequences. IBC is the largest Hispanic bank in the continental United States and
the damage to IBC’s stock price has harmed the minority employees, customers, shareholders
and communities that IBC serves. On April 7, 2009, the Treasury consented to IBC’s request.
Although the ability to repurchase some of its common stock should help IBC defend itself
against the short sellers, IBC is now fully aware of the devastating effect that unrestrained short
sellers can have on a company. IBC firmly believes there should be more reporting and
restraints with respect to short sellers as it is impossible to even determine who is short selling.

As of May 15, 2009, IBC’s short volume had increased over 860% to 11,311,974 total shares
shorted from the beginning of the year, at which time IBC had a total of 1,177,937 shares short.
This short interest now represents 21% of IBC’s recognized float and has driven IBC’s stock
price from a 52-week high of $35.80 prior to taking TARP funds, to a 52-week low of $6.55 in
March 2009. IBC believes its actual float amounts are much lower than those reflected in the
recognized float, such that the percent of short interest is even greater, based on the amount of
shares of IBC that are traded. IBC believes that its true “float,” the amount of shares that are
able to be shorted, is less than 30 million shares, making the true short interest closer to 37%.
IBC notes that it was included in the S&P Midcap 400 Index as of February 2, 2009, and while
the listing may have played a role in the increase of short interest in IBC, NASDAQ has
indicated that IBC’s sustained increase in volume since the listing is abnormal.\(^\text{15}\)

All of this market data evidences that short sellers have negatively impacted IBC’s share price.
The damage that irrational, sudden and excessive fluctuations of securities prices can create is
more severe with respect to financial institutions. Unfounded rumors made for the purpose of
driving down financial institutions’ share prices can create an ill-founded concern regarding the
financial stability of the financial institution. It is important to note that damage to confidence in
the financial sector presents a systemic risk to the economy. The Commission noted in the

\(^{15}\) Per conversation with Frank Hatheway, Senior Vice President and Chief Economist on May 27, 2009.
Proposed SHO Amendments, that “[s]uch rapid and steep price declines can give rise to questions about the underlying financial condition of an institution, which in turn can erode confidence even without an underlying financial basis.”16 IBC’s battle with short sellers exemplifies the Commission’s concern. As more and more companies lose analyst coverage, short sellers will have the ability to manipulate stock prices much easier, due to a lack of independent information to offset any manipulative reports used.17 The ability for a short seller to issue a negative report and spread it like wildfire over the internet is devastating. Under the current rules, companies do not have the ability to protect themselves from this sort of attack.

In addition, the Commission’s own actions have indicated that it believes short selling poses a serious risk. In July 2008, the Commission issued an emergency order to impose borrowing and delivery requirements on short sales of equity securities of financial institutions.18 This initial emergency order had little effect on the Commission’s concern that short sellers were having a negative impact on financial institutions.19 Even with the July short sale restrictions, Lehman Brothers saw its stock price plummet fifty-two percent (52%) on September 9, 2008, and another forty-two percent (42%) on September 11, 2008. This decline was partly due to exposure to the subprime crisis, but was exacerbated by false rumors and short sellers. Lehman Brothers exemplifies how short sellers can cause counterparties and investors to lose confidence in a financial institution, which in turn can lead to a systemic risk to the entire financial system. The Commission recognized this risk and on September 18, 2008, the Commission issued another emergency order prohibiting short selling in the publicly traded securities of certain financial institutions and other securities (the “Short Sale Ban”), including IBC.20

The combination of the Commission’s heightened concerns regarding financial institutions and actions regarding short sellers and the negative impact short sellers have had on IBC, outweighs all of the “economically insignificant” conclusions that the Commission relied on to eliminate the Uptick Rule originally. Therefore, IBC strongly urges the Commission to adopt a modified uptick rule based on the National Best Bid, which should apply at all times, and a circuit breaker which would halt any increase of a short position upon a ten percent (10%) intraday decline of an issuer’s stock price. In addition, IBC strongly urges the Commission to (1) vigorously enforce the current short selling rules; (2) institute a “pre-borrow” requirement for short sale transactions, or at the very least, make Rule 204T permanent; (3) promulgate disclosure rules for short sellers which mirror those obligations for long positions, (4) investigate the impact of the market maker exemption from the “locate” rule exemption under Regulation SHO in connection with the potential abuse of the clearing/settlement process creating naked short positions, and (5) promulgate rules which would require brokers to allocate lent stocks to specific margin account holders and disclose to the margin account holder of a loss of voting for those shares.

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17 See Jeff D. Opdyke and Annelena Lobb, MfA Analysts Give Companies Worries, THE WALL STREET JOURNAL (May 26, 2009) (noting that layoffs, attrition, retirement or brokerage firms moving analysts around is leading to more companies losing analyst coverage).
18 See Short Sale Emergency Ban Order.
19 See Proposed SHO Amendments, at 21.
1. The Commission should engage in more aggressive enforcement of short selling regulations to root out and prosecute manipulative short selling activities.

The U.S. Office of Inspector General ("OIG") released a report that showed the Commission's enforcement of short seller rules was inadequate, under the previous administration.\(^\text{21}\) The OIG noted that no procedures were in place at the Commission's Division of Enforcement to identify, address and effectively respond to manipulative short selling.\(^\text{22}\) Regulation SHO has recently been amended to tighten delivery requirements for shares that are shorted; however, these amendments are effective only to the extent they are enforced. The Commission, under the current administration, did not concur with the OIG's recommendations.\(^\text{23}\) IBC believes that the OIG's recommendations are critical to enforcing short seller rules. For example, IBC believes that the Commission should develop procedures to triage naked and manipulative short selling complaints.\(^\text{24}\) Rumor mongering, short and distort schemes, and abusive naked short selling present a systemic risk to the market when they are used against financial institutions. IBC urges the Commission to adopt written triage policies which put complaints against financial institutions through a more stringent review process.

The Commission has taken steps to curb short selling by tightening rules on short sellers. However, for those rules to be effective, they must be immediately and aggressively enforced. Therefore, IBC urges the Commission to adopt procedures to effectively enforce Regulation SHO, and to also adopt IBC's recommendations discussed below to create additional restrictions on short sellers and potentially manipulative short seller strategies.

2. The Commission should modify Regulation SHO, Rule 203 and Rule 204T to require all short sales be "pre-borrowed."

Regulation SHO, Rule 203, requires that short sellers either (i) have borrowed ("pre-borrowed") or entered into a bona fide arrangement to borrow the security, or (ii) have reasonable grounds to believe the security can be borrowed before the settlement date. As discussed below in greater detail, the Commission has defined a "naked" short sale to mean when a security is not delivered on settlement date.\(^\text{25}\) However, IBC believes a true "naked" short position is created when a short seller sells a stock without first borrowing the security. The current rules allow for a true naked short if a seller can conjure up "reasonable grounds" for not pre-borrowing the stock. By documenting a "reasonable ground," the short seller is allowed to have a naked short for three days. The Commission does not consider these short-term naked shorts a problem until the fourth day, if the stock is not delivered. On the fourth day, the Commission equates a failure to deliver to the creation of a "naked" short position.

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\(^{21}\) See Office of Inspector General, Office of Audits, Practices Related to Naked Short Selling Complaints and Referrals, March 18, 2009 (noting that between January 1, 2007 through June 1, 2008 only 123 out of over 5,000 short selling complaints were further investigated, but no enforcement actions were ever brought).

\(^{22}\) See id. at iii.

\(^{23}\) See id. at 40.

\(^{24}\) As was noted in the OIG's report, but was not agreed with the by Commission, see id. at 38 and 40.

\(^{25}\) See supra note 50 thorough 54, and accompanying text.
IBC believes that the three day location window provides a loophole for manipulative short selling activity. For three days, a naked short sale goes undetected and the short seller has a window in which they can add extra downward momentum on a stock, because without being forced to borrow the shares first, traders can short a limitless amount of stock. Additionally, pre-borrowing eliminates the probability that a stock lender will lend out the same shares to several different traders. While the current rules reduce the timeframe for short sellers to engage in manipulative strategies before being identified, IBC still believes that manipulative strategies, used prior to the more stringent rules, can still take place, albeit now in a shorter timeframe.

Furthermore, IBC believes that the current three day window allows for related third parties to “churn” their short interest positions within the window and prevent a failure to deliver on the fourth day. This means that the reports on failure to delivers could be understated and large naked short positions may still exist. IBC’s stock has seen a significant rise in the trading volume of its common stock. Since January 29, 2009, IBC’s trading volume has been abnormally high. IBC was listed in the S&P Midcap 400 on February 2, 2009, but this volume has remained higher or an abnormally longer period of time than what firms typically experience upon being listed. Since the beginning of the year, IBC’s short interest has grown 860% to over 21% of IBC’s recognized float. Exhibit A shows the dramatic shift in IBC’s volume and short interest trend. While IBC does not have any proof, due to the lack of transparency into short sellers and their interests, IBC believes that this increase in volume may represent evidence of the “churning” of short positions. By moving a short position back and forth between two parties, a true naked short position could be created, yet never become a failure to deliver. Therefore, naked short sellers may exist within the current legal framework, but the current legal framework doesn’t provide the protection it was intended to offer, due to this three day window.

Lastly, IBC sees no need for any window to locate shares given the significant impact of technology on the market, such as the dematerialization of stock certificates. Since certificates are moved electronically instead of physically, short sellers are able to locate shares immediately prior to engaging in a short position. While there may be an opportunity cost associated with searching for the security, that cost is likely small. Thus, a pre-borrowing requirement will not reduce efficiencies in the market. IBC does, however, recognize that there should be an exception for market makers, but only with clear guidance on legitimate market making activities provided by the Commission. Therefore, IBC asks that the Commission re-examine the three day window under Rule 203 and 204T, and promulgate a “pre-borrowing” requirement for all short sales.

3. The Commission should adopt regulations to require disclosure of short positions which mirror requirements for long positions.

IBC argues that the Commission should consider amending Regulation SHO to require disclosure of short positions that mirror the disclosure for long positions. IBC asks the

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26 See Liz Moyer, Curbing Short-Selling Abuse, FORBES (July 15, 2008).
27 As mentioned in note 15, this observation was made by an official at NASDAQ.
Commission to promulgate disclosure rules which trigger reporting requirements mirroring Exchange Act Section 13(d) for those with short economic interests in an equity security, either by (i) amending Exchange Act Rule 13d-3, or (ii) adding a similar provision in Regulation SHO. IBC notes derivative transactions should be disclosed as well, due to the high use of options and futures contracts to effectuate short economic interests outside of direct short and long positions in the underlying securities.

Currently, short interests and derivative transactions are hidden from issuers and investors. Section 13(d) of the Exchange Act was promulgated to regulate the amount of information asymmetry in the marketplace. Sizeable economic interests in a company, be it a long economic position or short economic position, can affect the price of a stock and corporate control. Commentators have noted that short sellers are taking on activist roles in corporate governance and policy. If an activist held a significant long position, Section 13(d) would require certain disclosures to inform the other security holders, and thus, reduce information asymmetry in the marketplace. However, the current regulations allow a short seller activist with the same economic position to remain anonymous simply because they are short. The current regulatory scheme for the disclosure of long economic positions versus short economic positions is one-sided and has eroded the overall effectiveness of Section 13(d) by creating information asymmetry based on the type of economic position held.

Under the current rules, the short positions in IBC stock are hidden behind a veil of secrecy, unlike long economic positions. IBC’s current short interest is over 21% of IBC’s recognized float, yet the current disclosure rules do not require any transparency by those short sellers. Per information provided from NASDAQ, a sizeable short position was initiated in IBC the last two weeks of February 2009. During this timeframe, IBC’s short interest doubled, but due to the current disclosure requirements, the holder of this position was not required to disclose anything to IBC and its investors. Furthermore, as noted earlier, IBC’s second and third highest days of trading volume occurred on the same days as a misleading analyst report was released. The current rules allow short sellers, whether acting in concert or not, to remain completely anonymous. Due to the one sided disclosure requirements, IBC and its investors do not know whether any short sellers hold sizeable short interests or their intentions; however, all holders know information for significant long positions.

This information asymmetry leads to uncertainty for investors. Due to the fact that IBC is a financial institution, this information asymmetry could pose a systemic risk to IBC and other financial institutions experiencing similar short interest growth. Thus, IBC asks that the Commission adopt a disclosure provision under Section 13(d) or under Regulation SHO, for short economic positions, mirroring the disclosure requirements for long economic positions under Section 13(d). Disclosure rules for specific economic interests should be parallel for both long and short positions and should not only be limited to significant long interests.

4. **The Commission should adopt the Modified Uptick Rule based on the National Best**

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Bid.

IBC strongly supports the Commission’s proposal to institute Proposed Rule 201(b)(1) and Proposed Rule 201(a)(2), establishing a modified uptick rule based on the national best bid (“Best Bid Uptick Rule”). The Commission’s Proposed SHO Amendments called for empirical data regarding the costs and benefits of reinstating short sales price tests. IBC believes that the empirical data used by the Commission to eliminate the Uptick Rule was economically inconclusive, and that IBC’s market data, as detailed above, shows conclusive evidence that a Best Bid Uptick Rule is needed to limit short term, speculative short sellers’ ability to negatively impact stocks.

A. The Uptick Rule was eliminated with no “economically significant” results to indicate the Uptick Rule was beneficial or detrimental to the market.

The reports discussed at the Pilot Roundtable, including the report by the OEA and other academic reports, concluded that the Uptick Rule was no longer necessary. However, this conclusion was based upon the absence of any economically significant positive or negative findings regarding the effect of the Uptick Rule. For example, the OEA found little empirical justification for maintaining the Uptick Rule for actively traded securities. Specifically, the OEA found that the Uptick Rule had (1) no impact on daily volatility, (2) limited impact of price distortion, and (3) no impact on market quality or liquidity of actively traded stocks. Therefore, the OEA report not only found little justification for maintaining the Uptick Rule, but also found little justification for eliminating it. Also, outside researchers looked at the data from the Pilot Program. These academics generally supported the removal of the Uptick Rule with mixed results, but the underlying results behind their conclusions were ultimately “economically inconclusive.”

Charles Jones, Professor of Finance at Columbia University, discussed his report at the Pilot Roundtable. Professor Jones looked at 1932 and the effect of the institution of the Uptick Rule on short sellers. He concluded that during this timeframe, liquidity improved while short interest declined. This appeared to support some sort of short seller restriction; however, Professor Jones noted that he could not extrapolate events from that timeframe to the current environment due to the drastically different market of the Great Depression. IBC argues that the current market environment represents a similar serious structural market change as that of the Great Depression; and therefore, is indicative of the positive impact of a short seller restriction can have during these structural changes. Professor Jones also concluded there was no change in volatility or volume, nor did it have a price impact upon the institution of the Uptick Rule originally.

29 Proposed Rule 201(b)(1) provides that “[a] trading center shall establish, maintain, and enforce written policies and procedures reasonably designed to prevent the execution or display of a short sale order in a covered security at a down bid price.” See Proposed SHO Amendments at 248.

30 Proposed Rule 201(a)(2) defines “down-bid price” as “a price that is less than the current national best bid or, if the last differently priced national best bid was greater than the current national best bid, a price that is less than or equal to the current national best bid.” Id.

31 See id. at 13.

32 See id. at 14, nt. 38.
Professor Ingrid Werner, Professor of Finance at The Ohio State University also presented her report at the Pilot Roundtable. Professor Ingrid looked at the actual Pilot Program to determine whether the Uptick Rule had a negative impact on the market. Professor Ingrid concluded that the Uptick Rule caused a decline in short sales and noted that the elimination may have had a small effect on liquidity. However, Professor Paul J. Irvine critiqued Professor Werner's report and noted that there was no "economic significance" to any of Professor Werner's findings. Furthermore, Professor Irvine noted that Professor Werner's report did not discuss what would have happened during unusual volatility. Thus, Professor Werner's report doesn't explain what benefit or detriment the Uptick Rule would have had in this current economic environment, which is characterized by extreme volatility.

Lastly, Gordon J. Alexander, Professor of Finance at the University of Minnesota, presented his report at the Pilot Roundtable which also discussed the impact of the Uptick Rule during the Pilot Program. Professor Alexander concluded that the Uptick Rule created (1) no change in short seller trading volume, (2) no change in implied volatility or in any other measure of volatility, and (3) no change in market efficiency. Therefore, Professor Alexander concluded that the data from the Pilot Program did not show whether the Uptick Rule was effective or not.

Thus, the Pilot Roundtable provided no economically significant data to find that the Uptick Rule was a benefit or detriment to the market. Furthermore, the Pilot Roundtable failed to look at the economic significance of the Uptick Rule on small vs. large market cap participants and also failed to look at so-called outliers. As noted in the Pilot Roundtable, the studies only looked at the averages of the participants in the study. Lastly, the data set from the Pilot Program was not representative of the Uptick Rule's operation during a significant structural change in the market. Thus, IBC argues that the Pilot Program produced no empirical evidence upon which the Commission should have relied to eliminate the Uptick Rule in the first place.

The Commission and the Proposed SHO Amendments have asked for empirical data regarding the cost and benefits of reinstating a short sale price test or imposing a circuit breaker rule and the impact on the market of reinstating such restrictions—noting that comment letters and requests thus far had not included any empirical data yet rather provided speculative opinions. IBC notes that no economically significant data was presented to the Commission when the Uptick Rule was eliminated, but that the impact of short sales on IBC's stock price is market data which shows the Commission should take action.

B. Due to a lack of academic empirical data, and with market data showing negative short seller impact, the Commission should adopt the Best Bid Uptick Rule.

During the Commission's proposal regarding eliminating the Uptick Rule and its Proposed SHO Amendments, the Commission called for empirical data. When eliminating the Uptick Rule, the Commission received no economically significant data, yet voted to eliminate the Uptick Rule. IBC strongly urges the Commission to adopt the Best Bid Uptick Rule in light of the market data showing the negative impact of unlimited short selling. IBC believes that this rule will help prevent potentially abusive or manipulative short selling from irrationally driving down an
issuer’s stock price. In the absence of economically significant evidence to the contrary, the Commission should adopt the Best Bid Uptick Rule in order to protect investors and bolster investor confidence. The Commission should not only rely on current short sale regulations and anti-fraud/anti-manipulation provisions of the securities laws to address potentially abusive short selling. The Commission’s resources are limited, and during a structural market event such as the current credit crisis, there are too many opportunities for abuse and not enough resources to monitor all situations.

IBC supports the adoption of the Best Bid Uptick Rule over a modified uptick rule based on the last sale price. As the Commission has noted, a modified uptick rule based on the national best bid is based on information that reflects current levels of buying and selling, as opposed to a last sale price which reflects past information and is subject to a potential ninety (90) second delay window. IBC believes that a Best Bid Uptick Rule, creating a short selling restriction, would drive relatively uninformed traders out of the pool of shorts, as some academics have found.33 Had the Best Bid Uptick Rule been in effect this year, IBC believes that uninformed, momentum short sellers would have been driven from the pool of short sellers of IBC’s stock. The Best Bid Uptick Rule would create an incremental cost which would deter relatively uninformed short trading, and by removing those uninformed short sellers, IBC believes that informed short sellers would have still acquired their positions and would have profited based on fundamentals, rather than from the added return speculative, uninformed short sellers caused in the stock.

While the Proposed SHO Amendments call for comments on numerous topics, IBC only addresses the following issues, regarding the Best Bid Uptick Rule:

(i) **IBC strongly urges the Best Bid Uptick Rule be adopted with no exemption for a broker-dealer engaging in a bona fide market making activity.**

IBC strongly urges the Commission to further investigate the implications of market markers being exempt from short selling rules. For example, the Commission should provide strict guidance on what constitutes “bona fide market making activity.” As noted below, the Commission’s attempt to clarify bona fide activities only clarified that “bona fide activities” were essentially determined by the market makers. A market maker’s job is to provide liquidity to the market. In a declining market, the market itself is providing liquidity on the sell side; therefore, the market maker should provide liquidity on the buy side. IBC believes that no market maker exemption is necessary to provide greater liquidity in a declining market and the Commission has reported no economically significant data to show otherwise. Therefore, IBC urges the Commission adopt final rules with no exemption for market makers, or at a minimum provide strict guidance for the definition of “bona fide market making activities.”

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(ii) IBC strongly urges the Best Bid Uptick Rule be adopted with no exemption for trades occurring after regular trading hours in the United States.

Under the Uptick Rule, the Commission interpreted the rule to apply to all trades in covered securities, regardless of what time the trade occurred. Therefore, any short sale was constrained to the last sale price reported at closing of the market. If the Commission were to adopt the Best Bid Uptick Rule without such a provision, then large market participants would be able to effectuate their trading strategies during after-hours trading. Thus, the Commission would create two different trading hours, one set for long positions during the regular hours and another set for short positions in the after-hours. This bifurcation would eliminate any possible benefits of the Best Bid Uptick Rule, and would simply shift the time frames of those transactions. Thus, IBC urges the Commission to have the Best Bid Uptick Rule apply during all trading time periods.

(iii) IBC strongly urges the Commission adopt the Best Bid Uptick Rule without a pilot study on the impact of such a rule.

The Commission’s Pilot Program was an experiment using the market to determine the effectiveness of the Uptick Rule. As noted earlier, the results of this experiment were inconclusive. In the Proposed SHO Amendments, the Commission seeks comment on whether it should engage in another pilot study to look at reinstituting some form of the Uptick rule. IBC strongly urges the Commission to forego a pilot program and promptly begin the three month implementation period.

As various panelists at the Pilot Roundtable discussed, the Pilot Program was unable to show what would happen during a structural changing event, such as the credit crisis. An additional pilot study at this point in time will not provide any more guidance on how the removed Uptick Rule would have performed in the past twelve (12) months. A pilot study is forward looking and cannot show how the Uptick Rule would have performed, unless those conditions occur again during the study. Due to the government’s response to the credit crisis, the probability of our markets experiencing another structural change in the next six (6) to twelve (12) months is low. Such a study would likely produce little or no benefit, while the cost of allowing short sellers to continue unrestricted is large. Therefore, IBC strongly urges the Commission to adopt the Best Bid Uptick Rule without a pilot study.

5. The Commission should immediately adopt a Circuit Breaker with a prohibition on short sales once triggered.

In addition to the Best Bid Uptick Rule, IBC strongly urges the Commission to adopt the proposed circuit breaker halt rule ("Circuit Breaker Halt Rule"). IBC urges the Commission to adopt the Circuit Breaker Halt Rule, such that upon a decline of ten percent (10%) in the price of a particular security, increases in short economic positions in that security, wherever it is traded, will be temporarily prohibited. IBC is against a circuit breaker uptick rule, which would apply a

modified uptick rule after the decline of some designated percentage, as IBC urges the Commission to adopt a Best Bid Uptick Rule which would apply at all times, as discussed above.

IBC believes that a Circuit Breaker Halt Rule would provide the ability to prevent severe “bear raids.” While most Self Regulated Organizations (“SRO”) have the ability to halt trading in a security, IBC believes that a uniform circuit breaker is necessary for investor confidence, and to act as a deterrent to bear raids. In addition to the Lehman Brothers example discussed earlier, on September 8, 2008, United Airlines (“UAL”) shares plummeted 76% due to unfounded rumors of a bankruptcy. Presumably, members of the bear raid on UAL shorted the stock down and then covered at or around the bottom. Had a Circuit Breaker Halt Rule been involved, IBC believes the extreme intraday volatility would have been limited and a complete trading halt of UAL stock would have been averted.

Furthermore, as the Commission has noted, a halting in increases of short economic positions allows the opportunity for investors to become aware, and respond to significant market movements. If a circuit breaker under the Circuit Breaker Halt Rule is triggered, investors would receive a market signal that would allow them to rationally evaluate if the downturn is due to fundamentals or short seller speculation. Thus, the Circuit Breaker Halt Rule would provide greater investor protection and instill confidence.

Regarding specific operation of the Circuit Breaker Halt Rule, IBC strongly urges the Commission to impose the Circuit Breaker Halt Rule where a ten percent (10%) decline in the price of a security would halt all increases in short economic positions for the remainder of the trading day. IBC agrees with the Commission that a ten percent (10%) decline trigger point, based on the security’s prior day closing price, is an appropriate level as it is consistent with current SRO Circuit Breakers. Furthermore, the Circuit Breaker Halt Rule provides a balance between the need to halt manipulative short selling and a market participant’s expectation that legitimate short selling strategies will be available.

The Commission asked for comments regarding a circuit breaker’s impact on “bear raids.” IBC believes that by instituting a Circuit Breaker Halt Rule, investors would be able to evaluate whether the breaker was triggered based on the incorporation of unfavorable information into the stock price, or if it was triggered due to non-fundamental actions, such as a “bear raid.” If investors determine that a “bear raid” is occurring, they will be able to adjust their holdings by taking advantage of this information to purchase more shares at this lower price. This will in turn push the price back to its fundamental value and counteract the bear raid. This brief halt will minimize the profitability of all “bear raid” strategies; and thus, deter “bear raids” in the market.

While the Proposed SHO Amendments call for comments on numerous topics, IBC only addresses the following issues, regarding the Circuit Breaker Halt Rule:

37 See Proposed SHO Amendments at 93.
38 See id. at 107.
A. IBC strongly urges the Commission to adopt the Circuit Breaker Halt Rule with a uniform trigger point and then commission a pilot study to look at different trigger levels for different stocks, but not commission a general pilot study.

IBC strongly urges the Commission to adopt the Circuit Breaker Halt Rule with a ten percent (10%) trigger point without a pilot study. IBC believes that immediate action is needed in order to provide stability in the market and restore investor confidence. IBC believes that the Commission should look at conducting a pilot study which varies the triggering levels for different types of stocks. IBC suggests the Commission conduct a pilot study to look at the impact of varying the trigger by market capitalization and by sector. Specifically, the Commission should look at decreasing the trigger point for financial institutions which pose a special systemic risk to the economy, and look at decreasing the trigger point for small cap companies who are likely most at risk for manipulative short selling strategies, due to a lack of analyst coverage.

B. IBC strongly urges the Commission to adopt the Circuit Breaker Halt Rule and have it be effective throughout the entire trading day.

The Commission noted that a proposed circuit breaker would not be triggered if there was a severe decline in the price of any security within thirty (30) minutes of the end of regular trading hours on any trading day. However, IBC strongly urges the Commission to apply the Circuit Breaker Halt Rule uniformly throughout the day. Just as IBC believes that the Best Bid Uptick Rule should apply at all times, IBC also believes that by allowing the Circuit Breaker Halt Rule to be relaxed during the last thirty (30) minutes, short sellers would be encouraged to engage in speculative strategies during that time frame. As mentioned above, UAL’s stock price was pushed down in a matter of minutes; therefore, a thirty (30) minute window would allow an opportunity for speculative short sellers to still effectuate severely manipulative schemes during that time frame.

C. IBC strongly urges the Commission adopt the Circuit Breaker Halt Rule without an exemption for options market markers selling short as part of bona fide market making in derivatives and hedging activities related to a security subject to a halt.

IBC believes short selling should be stopped in all forms once the Circuit Breaker Halt Rule is triggered and not allow any exceptions during this time. The reason for implementing a circuit breaker of any type is to give investors the ability to evaluate the market signal of a severe price decline. Investors during the decline must be assured that further selling pressure is not being put on the stock price by indirect means. Short sellers should not be able to exploit any loopholes by using derivatives and exemptions to increase their short position.

The Regulation SHO Amendments noted that during the Short Sale Ban, a market maker could not effect a short sale if the market maker knew that the customer’s or counterparty’s transaction

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39 See id. at 140.
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would result in the customer or counterparty establishing or increasing a net short position. The Commission argues that the time period of one day renders this provision moot. However, if the intention is to allow investors to process the downturn signal, no investors should be able to continue increasing a short interest in any form. Therefore, IBC asks the Commission remove the exemption for options market makers and reinstitute a provision for options market makers similar to those during the Short Sale Ban.

Similarly, on October 17, 2008, the Commission eliminated the options market maker exemption to the mandatory buy-in requirement of Regulation SHO, Rule 204T. However, Rule 204T, which requires clearing firms by 9:30 a.m. on the day after settlement date to close out short sales that did not settle, is set to expire on July 31, 2009. As discussed in detail throughout this letter, IBC urges the SEC to amend Rule 203 and Rule 204T to require all short sellers pre-borrow their shares prior to initiating a short sale, but at a minimum the Commission should make Rule 204T permanent with no options market maker exemption. The Commission believed that the elimination of the options market maker exemption would further reduce failures to deliver and addressed potentially abusive naked short selling when it took action in October 2008. Therefore, at a minimum, the Commission should make Rule 204T permanent with no exemption for options market makers as its reasoning still applies today.

6. **If the Commission adopts a Circuit Breaker which triggers the modified rule based on the national best bid, then the Commission should tailor the amendments to specifically address the risk to financial institutions.**

On March 24, the NYSE, NASDAQ and others exchanges (the “Exchanges”) sent a letter to the Commission with their recommendation for the amendments to Regulation SHO. The letter was sent prior to the Commission’s open meeting adopting the Proposed SHO Amendments and calling for comments on the proposed rules. The letter asked that the Commission institute a Best Bid Uptick Rule to apply when a circuit breaker is triggered (the “Exchange Proposal”), rather than having it apply constantly as IBC argues.

If the Commission agrees with the Exchanges and adopts final rules which mirror the Exchange Proposal, IBC asks that the Commission adjust the Exchange Proposal to provide greater protection to financial institutions, due to the special risks associated with reputational damage to that industry sector.

Both the Federal Reserve and the Commission acknowledged the systemic risk that market manipulators pose to financial institutions. These risks included a significant decline in stock

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40 See id. at 96.
41 Id. at 97.
43 For a further discussion, see Section 6 below.
44 See id. at 11.
45 See Short Sale Emergency Ban Order at 2
prices, the reduction of a financial institution’s ability to fairly deal with counterparties, risk of significant depositor withdrawals and an overall threat to fair and orderly markets. 46 IBC argues that these special risks will continue to exist if the Commission adopts the Exchange Proposal. Therefore, IBC asks that the Commission create special rules for all “financial institutions” 47 IBC argues that if the Exchange Proposal is adopted, then IBC’s proposal, the Best Bid Uptick Rule and Circuit Breaker Halt Rule, as previously discussed, should be adopted for financial institutions.

Currently, there is a bill in the Senate which would require the Commission to adopt a modified Uptick rule for “financial institutions.” 48 Therefore, the Commission should adopt the Best Bid Uptick Rule for “financial institutions.” At a minimum, the Commission should alter the Exchanges’ Proposal to have a Circuit Breaker Halt Rule for financial institutions. As noted earlier, financial institutions pose a special risk to the market. Without meaningful restrictions on short sellers, the past may repeat itself, causing a crisis of confidence with broad market consequences. 49 The Commission found a need to adopt emergency orders prohibiting all short sales for weeks, to allow investors to evaluate whether the price declines of financial institutions were signaling a change in fundamentals or a speculative short sale strategy. At a minimum, financial institutions, their investors and depositors, should be afforded at least an afternoon to evaluate a significant intraday decline without the fear of increasing short interests. Therefore, IBC asks that if the Commission adopts the Exchange Proposal, the Commission modify their proposal to allow for a Circuit Breaker Halt for financial institutions.

7. The Commission should examine the Market Maker exemption from the “Locate” Requirement under Rule 203(b)(2)(iii) and its effect on the market’s clearing system.

In addition to the Commission’s proposed amendments to Regulation SHO of an uptick test and circuit breaker, IBC also urges the Commission to investigate and provide transparency into the market maker exemption and clearing process related to naked short selling by market makers. Currently, there is little transparency into market making activities and the clearing process for issuers and investors. IBC believes that some market makers may be using the clearing process and Regulation SHO Rule 203(b)(2)(iii) to mask naked short sales. These short sales represent the same threat that the Commission faced when it implemented rules preventing naked short sales for individual investors. Therefore, IBC asks that the Commission investigate and provide data to stakeholders regarding the costs and benefits of Rule 203(b)(2)(iii).

An individual investor who wishes to enter a short position in a security is subject to the requirements of Regulation SHO. 50 Rule 203(b)(1) requires the short seller to borrow or arrange to borrow the securities in time to make delivery to the buyer within a standard three-day

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46 See id.
47 IBC recommends the Commission adopt the definition of “financial institutions” from the Short Sale Emergency Ban Order, Appendix A.
49 As noted by the Commission in the Short Sale Emergency Ban Order at 2.
50 17 CFR 242.203 et. seq.
settlement period from the trade date ("T+3" or "locate requirement"). If a short seller cannot "locate" the securities, a broker-dealer is not able to engage in the short sale transaction. When locating the shares, a short seller must borrow the security and deposit collateral with the lender (typically the proceeds from the sale of the security). This subjects the short seller to borrowing costs, including the loss of use of their deposit, the loss of interest from the deposit (which the lender receives), and the risk of additional margin calls. If the short seller fails to purchase or borrow the stock in accordance with the locate requirement, the short seller has "failed to deliver" ("FTD") and has a naked short position. Regulation SHO Rule 204T requires a broker to track all FTDs and then borrow or buy-in sufficient securities to close out those FTDs the beginning of regular trading on T+4.

According to Regulation SHO Rule 203(b)(2)(iii), a "market maker" is exempt from the "locate" requirement; and thus, may engage in naked short sale transactions if they are engaged in "bona-fide market making activities in the security for which the exemption is claimed." The Commission recently provided guidance on the definition of "bona-fide market making activities." However, this guidance simply confirmed that "bona fide market making activities" were in the discretion of the market maker. We are not aware of any publication where a market maker was required to defend their use of this exemption.

Therefore, market makers are able to engage in naked short sales without the borrowing costs associated with short selling. They do not have to borrow the stock; they have no transaction costs; they are not subject to margin requirements; and they have full use of the short sale proceeds immediately. Academics have proposed that market makers are strategically failing to deliver when borrowing costs are high; thus, they may be abusing their market maker exemption to produce the largest economic benefit for themselves, rather than using the exemption to provide needed liquidity to the market. There is currently no meaningful transparency into the transactions of market makers. Similarly, the number of FTDs by market makers is unknown.

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51 17 CFR 242.203(b)(1)
52 Id.
54 Rule 204T(a)(1).
55 See Exchange Act Section 3(a)(38), 15 U.S.C. 78c(a)(38) ("The term 'market maker' means any specialist permitted to act as a dealer, any dealer acting in the capacity of block positioner, and any dealer who, with respect to a security, holds himself out (by entering quotations in an inter-dealer communications system or otherwise) as being willing to buy and sell such security for his own account on a regular or continuous basis.").
56 17 CFR 242.203(b)(2)(iii)
58 See id. at 29 (stating that whether or not a market maker is engaged in bona fide market making would depend on the fact and circumstances of the particular activity).
59 Brooks and Moffett at 47.
60 Brooks and Moffett at 47.
61 See Brooks and Moffett at 48 (citing Boni, Leslie, Strategic Delivery Failures in U.S. Equity Markets," 9 JOURNAL OF FINANCIAL MARKETS 1, 1-26 (2006)).
Some academics believe that the market maker exemption allows for the creation of "phantom" securities. Once a market maker fails to deliver a security, there is a possibility that the market maker may sell the stock they were supposed to locate to another long investor. The unsuspecting long investor may purchase this phantom security and the market maker may place a marker in the investor’s account, which would act as a pledge to deliver the shares once they eventually locate those shares. The long investor believes that he has received "good delivery" of the phantom stock and may begin to exercise the fruits of ownership of that security, including voting power. However, if the market maker never "locates" the share, the long investor never actually gets the security, but there is no way for an investor to know whether his share is real or phantom. According to the Depository Trust Company ("DTC"), due to the complexity of the clearing and settlement system, it is not "feasible to trace any particular delivery or fail to deliver by a seller to any particular receive or fail to receive by a buyer."

This situation should be remedied by the clearing system. The DTC and/or the National Securities Clearing Corporation ("NSCC") have the power to either borrow the shares from another member account through the Stock Borrowing Program ("SBP"), or force the market maker to buy the security in the open market. However, unless the market maker is forced to "buy in," the NSCC’s borrowing of the stock may allow the FTD to remain permanent. This has the potential to leave phantom stock in the system.

Additionally, because our market system now aggregates certificates into fungible pools of shares that serve as sources for lending shares, broker’s cannot identify which shares of stock have been lent. Therefore, if Broker A has aggregated 100 shares from 100 investors, not held in margin accounts (thus, not lendable), and if Broker B has engaged in a naked short and goes to the NSCC to borrow the stock, who subsequently borrows that single share from Broker A, the NSCC has created a "phantom" share from a single "real" share. Neither the purchaser of the phantom stock, nor any of Broker A’s investors are aware of this. At a very minimum, additional voting rights are created, due to Broker A’s customer believing he or she has voting rights, and the new holder believing they have a right to vote as well. This is a problem for shares held in margin accounts as well, see Section 9 of this Letter, below.

The combination of the market maker exemption and broker example above creates a complexity with which investors and issuers should be concerned. The creation of phantom shares has serious consequences. Phantom shares create supply pressure on the market. Basic economics dictates that increased supply of shares results in depressed share prices. Furthermore, corporate governance is threatened as more shareholders hold voting power than the issuer has allowed. When actual certificates needed to be located prior to 1973, the holder

62 See id. at 47.
63 Brooks and Moffet note that the clearing process takes place in "back rooms" and is hidden from an individual investor, which was precipitated by the move to a custody system in 1973. The professors note that physical transfer of certificates created a bottleneck in the clearing process, but that the move to holding securities in street names and the use of the DTC and the NSCC has created a complex system that is entirely anonymous. Id. at 47-50.
64 Id. At 52.
65 Brooks and Moffett at 52.
66 Brooks and Moffett at 52-57.
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of the certificate was able to evidence their voting rights. The lender of the shares retained economic benefits of the shares, but surrendered their voting rights to the short seller. This waiver of voting rights no longer exists with the elimination of certificates. The broker example exemplifies this effect. Using the example above, if there are no lendable certificates, Broker A will potentially have 100 votes and Broker B will have 1 vote. The phantom share will expand the pool of voters. Broker A believes it has a 100% voting interest, but in reality will only have a 99% interest. If all interests are voted, the issuer will have overvoting in all proxy contests. This has been documented by various sources. Brokers have policies in place to “pro-rate” these overvotes. However, pro-rating explicitly acknowledges that phantom shares exist in the system and dilutes the voting power of legitimate votes.

The above example oversimplifies this complex issue; however, the possible outcomes are a serious concern for IBC, all issuers and investors. Therefore, IBC asks that the Commission investigate the market maker exemption and evaluate the costs and benefits of creating transparency in this part of the market. There is strong evidence that the Commission’s actions on September 18, 2008 had a profound effect on naked short selling trading. However, IBC believes that the Commission should examine the entire market system, including the market makers and clearing process, to ensure that investors are being protected and that the markets are able to operate efficiently.

A lack of transparency in this part of the market can lead to negative perceptions regarding the accuracy of reported FTDs. As noted by the Commission, this can lead to investors taking actions to prevent their stock from being transferred to securities intermediaries, such as the DTC or other broker-dealers by marketing their securities “custody only.” These actions could undermine the goal of a national clearance and settlement system. Therefore, IBC urges the Commission to provide transparency into this part of the market to promote investor confidence.

8. **If the Commission does not amend Regulation SHO to provide for a “pre-borrowing” requirement, the Commission should at least make Regulation SHO, Rule 204T permanent.**

As stated in Section 2, IBC urges the Commission to adopt a “pre-borrowing” requirement for all short sales transactions. Without a pre-borrowing requirement, short sellers have the ability to implement strategies around triggering a failure to deliver, such as through “churning” as mentioned above. However, if the Commission does not adopt IBC’s recommendation, then the Commission should at least make the automatic buy-in provisions of Rule 204T permanent.

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67 Brooks and Moffett at 52.
68 Books and Moffett at 56 (noting that the Securities Transfer Association found 341 cases of overvoting out of 341 cases reviewed in 2005).
69 See Bob Drummond, *One Share, One Vote: Short Selling Short Circuits System*, BLOOMBERG NEWS, March 1, 2006.
On September 17, 2008, as part of the Short Sale Ban, the Commission strengthened delivery requirements by adding an immediately effective provision to Regulation SHO, Rule 204T. Rule 204T imposes a penalty on any clearing agency participant which has an FTD. On October 14, 2008, the Commission adopted Rule 204T as it appeared in the Short Sale Ban. Rule 204T requires clearing agency participants to close out all FTDs by 9:30 a.m. on the day after settlement date ("T+4"), either by borrowing or purchasing securities of like kind and quantity.

Rule 204T also contains a sunset provision, and is set to expire on July 31, 2009. The Commission explained that the sunset provision would "enable the Commission to assess the operation of the temporary rule and intervening developments, including a restoration of stability to the financial markets, as well as public comments, and consider whether to continue the rule with or without modification at all." The number of FTDs has plummeted, to a daily average of 79 in the three months ending in March from 529 in the first nine months of 2008, according to an analysis of trading data from major stock exchanges done by the Wall Street Journal. IBC believes that naked short sellers are still operating within the three day window, but at least the current provision limits the time for their strategy and increases their costs by having to work around this provision. To allow Rule 204T to expire would be a dramatic step backwards.

Furthermore, on October 17, 2008, the Commission eliminated the options market maker exemption to the mandatory buy-in requirement of Regulation SHO. As discussed previously, the Commission believed that the elimination of the options market maker exemption would further reduce FTDs and addressed potentially abusive naked short selling. The reduction of FTDs takes into account Rule 204T with no market maker exemption. Therefore, Rule 204T as currently in effect should continue to address potentially abusive naked short selling. Thus, IBC argues that the Commission should make Rule 204T permanent with no exemption for options market makers.

9. The Commission should promulgate rules which require the allocation of shares lent, and disclose to those margin account holders that they no longer have voting rights in order to prevent the dilution of all shareholders.

Overvoting can have an invisible influence on a company. Commentators have noted that through the use of naked short sales, certain persons can potentially manipulate high stakes

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72 See supra note 23 and accompanying text.
74 Tom McGinty and Jenny Strasburg, Short Sellers Squeezed All Around: SEC Closes Loopholes as Some Firms Limit Stock Lending to Traders, THE WALL STREET JOURNAL (April 7, 2009).
76 See id. at 41.
elections. If Broker X lends a customer's shares from out of a margin account, because they are all pooled together, the customer doesn't know he or she doesn't have the shares to vote. This is regardless of whether the SBP has created additional "phantom shares," as discussed in Section 7. The margin account holders may vote in an election; and thus, in margin accounts, "phantom votes" are common place. The person who borrowed the shares is able to vote the shares, if they still have them in possession, or the person who purchases the shares from the short seller will vote them. Currently, the broker-dealers adjust the number of votes for each proposal by the number of overvotes. If there are not more votes than actual shares held by the brokerage, then no adjustment is made. In this scenario, "phantom votes" are still in the pool of eligible voters due to stock lending, just not obvious from vote tallies. Unless actual margin account holders have voting rights taken away, then the possibility of dilution is present.

Several large companies, such as Intel, and other large market participants, such as TIA-CREFF, have indicated that margin account stock lending allows for corporate governance to be gamed. IBC believes that short sellers can utilize short sales through margin stock lending to manipulate votes—even within the current regulations. Theoretically, a short seller can utilize the three day window around a record date to gain voting rights. By borrowing the shares from a margin account, there is the possibility that more votes are able to vote than duly and validly authorized by the issuer. An activist shareholder can utilize transaction to dilute other shareholders. This threat exists in today's regulatory scheme and IBC reiterates that the Commission should adopt a "pre-borrowing" requirement to prevent potential manipulation of voting rights.

If the Commission does not adopt a "pre-borrowing" requirement as discussed in Section 2, then IBC urges the Commission to require transparency into the practice of lending shares. IBC believes that shareholders should be able to have their shares held in a margin account and lent out, but if a broker lends shares then it must attribute the borrowed stock to a specific margin account holder. They should also notify the margin account holder that he or she no longer has voting rights due to the shares being lent. Currently, brokerages are not required to incorporate true transaction costs from the transaction. These costs are passed down to all shareholders of the issuer through the negative impact of overvoting. Therefore, the Commission should require those shares which are lent to be allocated and disclosed to the margin account holder.

CONCLUSION

The Commission eliminated the Uptick Rule in July 2007 after a pilot study, which provided economically insignificant results on the effectiveness of the Uptick Rule. Since that time, markets have experienced a roller coaster ride through increased volatility and wild swings in stock prices as the economy has experienced a structural market change. During this time, short sellers have engaged in abusive short selling strategies and negatively impacted certain stocks, causing some companies' fundamental values to be significantly detached from their stock price. Because the structural market change dealt with the credit crisis, financial institutions were, and are currently being, targeted by short sellers who utilize rumors to engage in abusive short selling.

78 Id.
strategies. The Commission identified this threat in July and September 2008 and issued emergency orders to protect financial institutions, identifying that abusive short seller strategies posed a systemic risk to all financial institutions. The Commission should continue protecting financial institutions and other issuers from the continuing threat posed by abusive short sellers.

IBC is a well capitalized $12.4 billion multi-bank financial holding company headquartered in Laredo, Texas. Because it took TARP funds at the Treasury’s request, it does not have any analyst coverage, and due to its relatively smaller market capitalization in the financial sector, IBC has been the victim of speculative short sellers who have driven a wedge between IBC’s fundamental value and its stock price. Since taking TARP funds, IBC’s short interest has grown 860% and its stock price has been reduced from over $24 to a low of $6.55. This has created unwarranted concern in IBC’s financial condition and poses a threat to IBC, its shareholders and depositors. Furthermore, the increase of IBC’s short interest to over 11 million shares shorted creates enormous opportunities for overvoting and significantly dilutes the property rights of IBC’s shareholders.

Because of the threat to IBC and other financial institutions posed by short sellers, IBC strongly urges the Commission to adopt a modified uptick rule based on the National Best Bid, and adopt a circuit breaker rule that would halt any increases in short positions in a particular security that suffers a ten percent (10%) intraday decline. In addition to the Commission’s call for comments on reinstating an uptick rule and creating circuit breakers, IBC also respectfully asks the Commission to: (1) vigorously enforce the current short selling rules; (2) institute a “pre-borrow” requirement for short sale transactions, or at the very least, make Rule 204T permanent; (3) promulgate disclosure rules for short sellers which mirror those obligations for long positions, (4) investigate the impact of the market maker exemption from the “locate” rule exemption under Regulation SHO in connection with the potential abuse of the clearing/settlement process creating naked short positions, and (5) promulgate rules which would require brokers to allocate lent stocks to specific margin account holders and disclose to the margin account holder of a loss of voting for those shares.

Thank you for your consideration of this letter. If you have any questions or would like any further information regarding the issues raised in this letter, please call the undersigned at (956) 726-6614.

Sincerely,

Dennis Nixon
Chief Executive Officer and Chairman
International Bancshares Corporation

cc: Robert Khuzami, Director, Division of Enforcement
John W. While, Director, Division of Corporation Finance
James Brigagliano, Co-Acting Division of Trading and Markets
Daniel M. Gallagher, CO-Acting Division of Trading and Markets
Exhibit A

Trend Analysis of IBC's Short Interest and Volume

[Graph showing trend analysis of IBC's short interest and volume with dates from 9/20/2008 to 4/30/2009]
The Honorable Mary L. Schapiro, Chairman  
The Honorable Kathleen L. Casey, Commissioner  
The Honorable Elisse B. Walter, Commissioner  
The Honorable Luis A. Aguilar, Commissioner  
The Honorable Troy A. Paredes, Commissioner  
United States Securities and Exchange Commission  
100 F. Street, NE  
Washington, D.C. 20549-0609

Re: Securities and Exchange Commission Release No. 34-59748; File No. S7-08-09 (the  
“Proposed SHO Amendments”)

Dear Chairman and Commissioners:

International Bancshares Corporation (“IBC”), again respectfully submits this letter in response  
to the above release as a means to supplement IBC’s original comment letter filed with the  
Commission on June 9, 2009. As discussed in more detail in IBC’s original comment letter,  
IBC fully supports the Commission’s proposed rule to amend Regulation SHO under the  
Exchange Act of 1934 (the “Exchange Act”) to adopt a modified uptick rule based on the  
National Best Bid, and adopt a circuit breaker rule that would halt any increases in short  
positions in a particular security that suffers a ten percent (10%) intraday decline. In addition to  
the Commission’s call for comments on reinstating an uptick rule and creating circuit breakers,  
IBC also respectfully asks the Commission to: (1) vigorously enforce the current short selling  
rules; (2) institute a “pre-borrow” requirement for short sale transactions, or at the very least,  
make Rule 204T permanent; (3) promulgate disclosure rules for short sellers which mirror those  
obligations for long positions, (4) investigate the impact of the market maker exemption from the  
“locate” rule exemption under Regulation SHO in connection with the potential abuse of the  
clearing/settlement process creating naked short positions, and (5) promulgate rules which would  
require brokers to allocate lent stocks to specific margin account holders and disclose to the  
margin account holder of a loss of voting for those shares.

The purpose of this second comment letter is to emphasize that IBC strongly believes the lack of  
reporting and transparency regarding short selling activities facilitates the nefarious actions of a  
handful of short selling predators to the detriment of thousands of legitimate shareholders  
holding long positions. While the argument is often made that in a free market both the short and  
long sides of the market must be allowed to freely function, there is no rational basis to allow the  
short side of the market to function in the shadows without the same level of transparency and  
disclosures that apply to the long side of the market. It is illogical that while the dispensing of

1 (NASDAQ: MOCH) is a $12.4 billion multi-bank financial holding company headquartered in Laredo, Texas, with  
over 265 facilities and over 420 ATMs serving more than 101 communities in Texas and Oklahoma.  
information by the registrant and investors on the long side of the market is highly restricted and prohibits materially misleading or incomplete information, the short side of the market is allowed to freely publish manipulative reports that distort and exaggerate negative information for the purpose of creating doubt and confusion. This distortion is exacerbated by the inability of the long side of the market to effectively counter the abusive misinformation proffered by the short traders.

This information asymmetry grants an unfair advantage to short sellers and is inherently unfair to shareholders holding long positions. It is critical that the Commission adopt symmetrical disclosure rules in order to remedy the current regulatory structure that has the effect of protecting the manipulative abuses of a small number of short traders at the expense of an overwhelming majority of investors holding long positions. These changes would be consistent with the Commission’s stated goal to enact reforms to improve investor protection and restore confidence in our markets.

Thank you for your consideration of this letter. If you have any questions or would like any further information regarding the issues raised in this letter, please call the undersigned at (956) 726-6614.

Sincerely,

Dennis Nixon
Chief Executive Officer and Chairman
International Bancshares Corporation

cc: Robert Khuzami, Director, Division of Enforcement
    John W. While, Director, Division of Corporation Finance
    James Brigagliano, Co-Acting Division of Trading and Markets
    Daniel M. Gallagher, CO-Acting Division of Trading and Markets
EXHIBIT D

Trend Analysis of IBC's Short Interest and Volume

FTD
Volume
Short Interest

Shares (Actual Amount)

FTD Amount of Shares

Date

1/1/2009
1/15/2009
1/29/2009
2/12/2009
2/26/2009
3/12/2009
3/26/2009
4/9/2009
4/23/2009
5/7/2009
5/21/2009

Purchases ahead of S&P 400
First Report
Second Report
20% of Recognized Float
EXHIBIT E

SMA(20,1w): 27.08

Zoom: 1d 5d 1m 3m 6m YTD 1v 5v 10v Max

Feb 06, 2004 Price: 29.902 Vol: 148.50k

Volume (mil / 1wk)