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

June 22, 2011

Via Electronic Mail: rule-comments@sec.gov

Elizabeth M. Murphy
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Short Sale Reporting Study Required by Dodd-Frank Act Sec. 417(a)(2); File No. 4-627

Dear Ms. Murphy:

Managed Funds Association ("MFA")[1] appreciates the opportunity to provide comments to the Securities and Exchange Commission (the "SEC" or "Commission") with regards to studies required by the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") on short selling.[2] Section 417(a)(2) of the Dodd-Frank Act requires the Commission to study the feasibility, benefits and costs of: (1) requiring real-time public reporting of short sale positions or in the alternative, real-time reporting of short sale positions only to the Commission and the Financial Industry Regulatory Authority ("FINRA"); and (2) conducting a voluntary pilot program in which public companies would agree to have all trades of their shares marked "long," "short," "market maker short," "buy," or "buy-to-cover," and reported as such in real-time through the Consolidated Tape.

I. Background

As the Commission is well aware, short selling provides the market with important benefits, including market liquidity and pricing efficiency.[3] Short selling is an essential method

[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 $2.0 trillion invested in absolute return strategies. MFA is headquartered in Washington, D.C., with an office in New York.

[2] Short Sale Reporting Study Required by Dodd-Frank Act Section 417(a)(2), Exchange Act Release No. 64383; File No. 4-627 (May 3, 2011) [hereinafter, the "Release"].

[3] Proposed Amendments to Regulation SHO, 74 FR 18042, 18044 (Apr. 20, 2009). *See also, Exchange* Act Rel. No. 29278 (June 7, 1991), 56 *FR* 27280 (June 13, 1991); 2004 Regulation SHO Adopting Release, 69 *FR* 48008; Boehmer, Ekkehart and Wu, Julie, *Short selling and the Informational Efficiency of Prices* (Jan. 8, 2009); Arturo Bris, William N. Goetzmann and Ning Zhu, "Efficiency and the Bear: Short Sales and Markets Around the World" (Yale School of Management, Jan. 2003), (a study of forty-seven stock markets around the world, in which the authors found that markets with active short sellers reacted to information more quickly and set prices more

by which investors, including fiduciaries managing others' assets, can manage risk, hedge their portfolios, contribute to capital formation[4] and reflect their view that the current market price of a security is above its fair value. Short selling is a key component of investment risk mitigation and is required as part of implementing numerous investment strategies.

There appears to be substantial confusion among the general public and some commentators over the role of short selling as a necessary investment practice and risk mitigation technique and the illegal practice of so-called naked short selling, especially since the empirical evidence does not support the claims that short selling or naked short selling were responsible for declining stock prices in recent years. In fact, academic studies on the effects of short selling, most notably those examining the effects of short selling prohibitions in 2008, strongly support the view that short selling contributes to pricing efficiency and that short selling restrictions decreased trading volume and market liquidity, and increased bid-ask spreads and volatility.[5]

II. General Comments

MFA opposes market manipulation of any kind—whether through stock purchases or sales. Our members depend on honest markets and fully support efforts to ensure that regulators have the necessary means to protect market integrity. As the Commission engages in its short sale reporting study, we respectfully urge it carefully to examine all relevant facts. A study, as with rulemaking, should be clearly defined and recommendations should be supported by empirical data and measured by a cost-benefit analysis. Otherwise, it could lead to rulemaking that is costly, ineffective, and detrimental to our capital markets and investor confidence.

In general, we have concerns, as discussed below, that the two proposals subject to Commission study would provide little benefit to the general public, but more importantly, the short-sale information gathered would be misleading to market participants. We are also concerned that the "attributed" short sale information would be deleterious to and perhaps intimidate investors that use short selling as part of their risk reduction techniques; useable and

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accurately); *and* Owen A. Lamont, "Go Down Fighting: Short Sellers vs. Firms", *available at* http://www.som.yale.edu/faculty/oa14/research/go%20down%20fighting.pdf (concluding that constraints on short selling as a result of various actions taken by firms allow stocks to be overpriced and that firms taking anti-shorting actions have in subsequent year abnormally low returns of about minus two percent per month).

[4] *See* letter to Christopher Cox, Chairman, SEC, from Richard H. Baker, President and CEO, Managed Funds Association on Oct. 1, 2008 (discussing that the SEC Order Halting Short Selling had the perverse effect of making it harder for financial companies to raise capital through convertible bond and convertible preferred securities issuances as investors were not willing to make investments without the ability to manage their risk through hedging techniques).

[5] *See e.g.*, Ekkehart Boehmer et al., Shackling Short Sellers: The 2008 Shorting Ban, September 25, 2009, *available at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1412844*; Bris, A., Goetzmann, W. N., Zhu, N., Efficiency and the Bear: Short Sales and Markets Around the World, 2007, Journal of Finance, Vol. 59, No. 4; Abraham Lioui, The Undesirable Effects of Banning Short Saels, EDHEC Business School, Risk and Asset Management Research Centre, April 2009; The Blame Game: What Caused Spreads to Widen, AES Analysis, Credit Suisse, Nov. 12, 2008; *and* Matthew Clifton et al., The Effect of Short-Selling Restrictions on liquidity: Evidence from the London Stock Exchange, Capital Markets Cooperative Research Centre, Dec. 12, 2008.

readily available short sale data would be extremely challenging to index; and the proposals would be costly and would directly impact our liquid and robust markets in a negative manner.

We believe the Commission's Regulation SHO ("Reg SHO") framework for regulating short selling has worked exceedingly well by implementing appropriate regulation and oversight over the activity to allow markets to increase efficiency. Reg SHO addressed a specific and substantial short-selling abuse—settlement failures—by implementing targeted and empirically supported measures.

For example, Rule 204 of Reg SHO, which mandates a strict T+4 close-out of securities that fail to settle on settlement date, has been tremendously successful in reducing failures to deliver or so-called "naked" short selling.[6] Failures to deliver decreased by 56.6%, while threshold securities declined by 77.5%.[7] The Commission also implemented Rule 10b-21 to target naked short selling.[8] MFA fully supports the Commission's efforts to combat manipulative short selling, including strict enforcement of locate and delivery rules, as well as its other efforts to deter and detect market abuses.

Under the existing framework, we believe the Commission could take further steps to enhance Reg SHO by requiring clearing brokers to perform daily reconciliations to identify short sales that they process with respect to whether a market participant performed a locate in advance of the trade. The Commission could also enhance market transparency by providing the public with more frequent, enhanced aggregated short sale data, as well as enhanced reports on aggregate purchases and long sales in an individual security. We believe greater high-level market information could help dispel the public's misperception of short selling.

In this regard, we believe the public could benefit from additional aggregate reporting of trading activity in a security, including a breakdown of aggregate purchases, long sales and short sales in a security. Aggregate reporting would bring greater insight to trading activity and address misperceptions in a market. Such information would have clearly demonstrated that price declines in a security during the extreme price declines of 2008 were the result of selling activity by long sellers.[9] We believe the Commission should collect order information for all

[6] The Commission has not defined "naked" short selling but has generally referred to it as "short selling without having securities available for delivery and intentionally failing to deliver securities within the standard three-day settlement cycle." *See* Regulation SHO Final Amendments, Exchange Act Release No. 56212 (Aug. 7, 2007), 72 *FR* 45544 (Aug. 14, 2007) ("2007 Regulation SHO Final Amendments"); Regulation SHO Proposed Amendments, Exchange Act Release No. 54154 (July 14, 2006), 71 *FR* 41710 (July 21, 2006) ("2006 Regulation SHO Proposed Amendments"); Regulation SHO Adoption Release, Exchange Act Release No. 50103 (July 28, 2004), 69 *FR* 48008, 48009 n.10 (Aug. 6, 2004) ("2004 Regulation SHO Adopting Release"). We note that not all "naked" short selling is illegal.

[7] Final Amendments to Regulation SHO, 74 *FR* 38266 (July 31, 2009).

[8] Adoption of "Naked" Short Selling Antifraud Rule, 73 *FR* 61666 (Oct. 17, 2008).

[9] *See* OEA Dec. 16 Memo to Chairman; *and* Shorting Financial Stocks Should Resume, Arturo Bris, WSJ, Sept. 29, 2008 (providing that short sales in the 799 stocks amounted to a low 6% of shares outstanding prior to the short sale ban).

securities and provide weekly aggregated reports, including charts that help illustrate market activity.[10]

Individual positions of market participants, however, only should be provided confidentially to the SEC.[11] As discussed in our letter, we have strong concerns with public individual position reporting and believe, based on the numerous reasons an investor incorporates short-selling into its strategy, that it would most likely be misleading rather than beneficial to the public. Public disclosure of individual market participants' trade positions could have the perverse effect of increasing market volatility, being potentially misleading to the public, and cause further downward pressure on a stock as less sophisticated market participants are influenced to sell by the short-sale reports without understanding the rationale behind the reports. Public disclosure would also cause irreparable harm to institutional investors, such as pensions, endowments and foundations, as well as retail investors, in funds that employ such risk mitigation techniques.[12]

III. Baseline Questions

As active market participants, we are not aware of, nor have we perceived there to be, episodes of abusive short selling where an equity security is sold short to drive down a security's price by creating an imbalance of sell-side interest. Such activity could be highly risky since there is unlimited loss potential associated with short sales as the future stock repurchase price could in theory go up infinitely. The claims that short selling was responsible for steep price declines in 2008-2009 are simply not true and not supported by any factual evidence. While the allegations ignited a series of investigations by regulators and law enforcement agencies, including the Commission, into whether hedge funds and other short sellers were intentionally driving down the price of certain bank and broker-dealer stock prices, no wrongdoing was found.[13] In fact, the Commission's own analysis of short selling activity in 2008 found that episodes of extreme negative returns were not the result of short selling activity, but from selling activity by sellers who own the stock (long sellers).[14] Studies, such as by the Financial Crisis

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[10] One possibility would be for the Commission to collect information similar to FINRA's order audit trail system for the entire market.

[11] *See* letter from Stuart J. Kaswell, Executive Vice President and General Counsel, Managed Funds Association, to Florence E. Harmon, Acting Secretary, Securities and Exchange Commission, dated Dec. 15, 2008 *available at:* http://www.managedfunds.org/downloads/MFA%20Rule%20204T%20Comments.12.15.08.final.pdf.

[12] *See* letter from Richard H. Baker, President and CEO, Managed Funds Association, to James A. Brigagliano, Deputy Director, Division of Trading & Markets, SEC, dated Feb. 7, 2011, on Section 929X of the Dodd-Frank Act, *available at:* http://www.managedfunds.org/downloads/MFA.Letter.on.Short.Sale.Disclosures.under.Section.929X.of.Dodd.Frank.pdf.

[13] *See, e.g., Over 50 Hedge-Fund Advisers Subpoenaed in Short-Selling Probe,* REUTERS, Jul. 15, 2008; *NYAG and SEC Announce Wide-Ranging Market Manipulation Probes; SEC Adopts New Rules to Combat Abusive Short-Selling,* Paul Hastings Client Alert, September 2008, at n. 8.

[14] OEA Memorandum from Daniel Aromi and Cecilia Caglio through James Overdahl to Chairman Christopher Cox, dated December 16, 2008, on the analysis of short selling activity during the first weeks of September 2008.

Inquiry Commission, have since concluded that factors, including risky subprime lending and securitization, excessive borrowing, risky investments, and a collapse in mortgage lending standards, were responsible for the financial crisis of 2008-2009.[15]

Currently, FINRA produces daily short sale volume data, bi-monthly short interest reports, and monthly short sale transaction data. While we believe such information is interesting and helpful, we believe it would be more helpful to the general public if FINRA or the Commission were to put the data into a chart or graph. From our experience, data that is too granular is not as meaningful to the general public, and that it only becomes meaningful if it is analyzed or explained, such as through charts or compared with other data points.

Some foreign jurisdictions, for example, provide weekly updates on short selling by showing aggregate short sale levels for the overall market, certain industry sectors and the top ten securities sold short.[16]

IV. Short Sale Position Reporting

For the reasons discussed below, we are generally concerned with individual public short sale position reporting. We believe it would be preferable to report individual short positions to regulators on a confidential basis; and would support such reporting to the extent the Commission determines through a cost-benefit analysis that individual short positions reports would be meaningful to its market oversight initiatives. We respectfully urge the Commission to consider its experience with Form SH in evaluating the usefulness of such reports over the burden imposed on investors and other market participants.[17]

A. Real-Time Reporting and the Use of Such Information

The Commission requests information on the feasibility of real-time reporting of short positions by individual market participants. We do not believe it is feasible to require all market participants to report short sale positions real-time. A real-time short sale position reporting regime would require both buy-side and sell-side firms to develop automated and sophisticated

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The study also found that short selling is higher during periods of extremely positive returns than in periods of extreme negative returns.

[15] Report of the Financial Crisis Inquiry Commission *available at:* http://fcic.law.stanford.edu/report. *See also,* How exactly did inequality fuel the crisis?, The Economist, Aug. 27, 2010; Mortimer B. Zuckerman, Who to Blame for the Financial Crisis, U.S. News & World Report, Jan. 29, 2010; John Stepek, Short-sellers didn't cause this crisis – the government did and bankers did, MoneyWeek, Sept. 18, 2008; *and* Houman B. Shadab, Hedge Funds and the Financial Crisis, Mercatus Center, George Mason University, January 2009 (stating that hedge funds did not cause the financial crisis, but are reducing the crisis' overall impact and helping the economy to recover).

[16] *See, e.g.,* Weekly update on Hong Kong's short-selling pattern, Hong Kong Securities and Futures Commission, *available at:* http://www.sfc.hk/sfc/html/EN/general/general/short-selling/short-selling.html (providing a weekly comparison of total aggregate short selling in Hong Kong for the whole market, certain industry sectors and the top ten securities sold short) *available at:* http://www.arturobris.com/eo/brisreportAug12.pdf.

[17] Disclosure of Short Sale and Short Positions by Institutional Investment Managers, Exchange Act Release No. 58785, 73 *FR* 178 (Oct. 17, 2008).

computer logic. Such a regime would impose a heavy burden on investors and counterparts for little benefit, especially for individual or smaller investors with less sophisticated information technology systems.

Importantly, the Commission asks who would use real-time short position data and how would such data affect market participants.[18] We believe the sphere of market participants that would be able to use such information would be strictly limited to highly sophisticated investors who are able to use technology to analyze, digest and act upon such data. Real-time short position reports would be too frequent and granular for the general public to understand, as short sales are executed in connection with numerous and differing investment requirements. Frequent information dissemination could have the effect of reducing investor confidence to purchase a security if potential purchasers equate short sales activity with negative forecasting on a security's future value.

B. Concerns with Public Short Position Reporting

Public disclosure of individual short positions likely to be misinterpreted by investors.

We believe public disclosure of individual short positions disadvantages those issuers whose stock is shorted and the investors who are holding a position in that stock. Public disclosure of short positions is likely to be misinterpreted, as investors frequently short a stock for portfolio risk management purposes rather than because they have taken a negative fundamental view on a particular issuer. For example, an investor that is primarily long in stocks in a particular industry sector may consider that one issuer's stock is likely to outperform another and may express that view by going long the first and short the second stock. As estimated by Credit Suisse, only 0.7% of all hedge fund strategies are dedicated solely to short selling. The remaining 99.3% of strategies involve shorting as part of a hedging strategy.[19] Therefore, the investing public will mistakenly interpret disclosure of the information on the short sale as an absolute negative view on that issuer's prospects. Misinterpretation of this information is likely to have a greater impact on those industry sectors which are vulnerable to negative public sentiment, in particular financial institutions.

Also, we believe short position reports could be misleading if purchases to cover short sales were not reported. Otherwise, real-time daily reporting would only show growing short positions and not the close-out transactions.

Public disclosure leads to "herding" and increased volatility.

Public disclosure of individual market participants' short positions may lead to an increase in shorting of stocks as other market participants seek to execute trades which follow firms' publicized short positions. This would increase market volatility as potential buyers may be less likely to purchase as they equate short sale reports with negative information on a

[18] Release at p. 8.

[19] Ticking off the Shorts, AES Analysis, Credit Suisse, Apr. 23, 2009.

security. Short sale reports could also deter corporations from issuing secondary offerings if they perceive short activity to be increasing.

There are many real-world examples where the behavior of a high profile investor is likely to have influenced the activity of other market participants.[20] This is a particular concern for MFA members, many of whom have well established market reputations.

Public disclosure may cause issuers to react adversely to investors that use short selling as a risk mitigation technique.

Public disclosure of individual short positions would also have harmful consequences to investors. A number of issuers have indicated that if they can identify which firms have been shorting their securities, they will cease or limit communications with analysts of those firms and exclude them from information sessions. Such a result would have a negative impact on capital markets by limiting the free flow of information essential for informed investments and effective price discovery. We are concerned that public disclosure of detailed short positions would have long lasting negative effects on markets by having a chilling effect on the information and disclosure provided by issuers, as well as harming the relationship between investors and issuers. This is a particular concern for MFA members, who believe that it is necessary to have equal access to information from issuers to better serve their own investors by pursuing properly informed investment strategies.

Adverse publicity arising from public disclosure may avert investors from benefiting from alternative investment classes.

In addition, a number of pension, endowment and foundation investors in the U.S. have indicated to our members that because of risks of adverse publicity resulting from public misunderstanding of the function of short selling, they would likely modify their investments from investment vehicles engaged in short selling if they were required publicly to disclose short positions. In the long-term, such investors would forego diversification and risk management benefits provided by alternative investment vehicles.

Adverse publicity associated with public disclosure may discourage use of hedging strategies.

Public disclosure of individual short position information could have unintended consequences to hedging strategies of investors. Hedging strategies are a critical, and the primary, risk management tool of investors and enable them to make investments on the long

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[20] *See, e.g.,* Steve Eder, et. al., "Green Bears, Bank Bulls and Insurance Cyclers", WSJ, May 26, 2011; "Market Talk: Einhorn Negative on St. Joe, Shares Drop", Dow Jones Newswires, Oct. 13, 2010. Activities and commentary of prominent investors or analysts may have profound influence on others' market activities. *Cf.* information on Henry Kaufman *available at:* http://en.wikipedia.org/wiki/Henry_Kaufman (Kaufman earned the nickname "Dr. Doom" for his prediction on August 17, 1982 that interest rates would fall, which sparked a stock market rally that can be dated as the beginning of the 1980s bull market); Dr. Doom (Nouriel Roubini) Himself May Hold Key to Market Recovery, *Thoughtsworththinking.net*, Apr. 24, 2009 *available at:* http://www.thoughtsworththinking.net/2009/04/dr-doom-nouriel-roubini-himself-may-hold-key-to-market-recovery/.

side of the market. Short selling is an essential component of a wide range of bona fide hedging strategies by which investors provide liquidity to the financial markets. Because of concerns about adverse publicity, public disclosure of individual short positions may discourage investors from engaging in short sale transactions for hedging purposes, reducing investors' ability to manage risk, and decreasing market liquidity and capital formation. While these concerns would be reduced if a short sale position disclosure threshold was set and if an investor's net short position for a particular security remains below the disclosure threshold, investors, such as MFA members, frequently hedge risk through short sales of different issuers with highly correlated share prices (e.g., companies in the same industry sector).

With the reduced usage of hedging strategies there may also be unanticipated secondary effects. Certain investment strategies use short equity positions to hedge exposures in other products. Convertible arbitrage, for example, relies on short equity positions to hedge exposure in convertible bonds. Were alternative investment managers and other investors to lose the ability to hedge these risks there is a possibility that their appetite for products such as convertible bonds could diminish. As convertible bonds represent a cheaper source of funding than traditional bond issuance short selling disclosure could have real impacts on the financing ability of companies whose equity is subject to regulation. There are many MFA members that pursue these strategies and are significant investors in primary offerings of convertible securities.

Public disclosure exposes investors to risks of short squeezes.

In addition, public disclosure of short positions may expose market participants to the risk of a short squeeze[21], which again may deter investors from engaging in short selling. The Commission of European Securities Regulators noted in its Proposal for a Pan-European Short Selling Disclosure Regime that there has been no study which can confirm that these risks are not significant.[22] Short sellers have unlimited risk as theoretically the price of a security could rise infinitely.

Public disclosure reduces incentives to develop trading strategies that use short selling.

Public disclosure of individual short positions could permit other market participants to unfairly reverse engineer the trading strategies of an investor. Public disclosure would likely cause harm to the trading strategies of investment managers, and by direct implication the billions of dollars invested in those strategies by investors through vehicles such as pensions, endowments and foundations, as competitors will be able to use the publicly disclosed information not only to profit in the short term from the known positions, but also to reverse engineer the trading strategies themselves.

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[21] A short squeeze occurs where the price of a security rises as a result of increased demand and limited supply, causing investors to purchase shares to close out their short positions, creating a further increase in demand for securities which are already in limited supply, triggering a further rise in price.

[22] CESR Proposal for a Pan-European Short Selling Disclosure Regime, Committee of European Securities Regulators, July 9, 2009, *available at:* http://www.cesr-eu.org/popup2.php?id=5791.

Policy grounds for public disclosure of long positions are fundamentally different.

In addition, requirements for individual investors to publicly disclose their short positions need to be based on fundamentally different policy grounds than requirements on holders of long positions publicly to disclose their individual positions. Appropriate public disclosure of long equity positions is justified because investors and other stakeholders have a legitimate interest in knowing who controls the voting rights attached to shares and the size of their stakes. There is no corresponding need for investors or other stakeholders to know the identity of holders of short positions, as holders of short positions do not exercise any voting rights. Secondly, holders of long equity positions have a relatively lower degree of exposure to loss as a result of disclosure of their positions. Holders of short positions are exposed to unlimited loss in the event of stock prices increasing before they can unwind their position and are also exposed to potential squeezes as a result of public disclosure as it is clear that they will be required to unwind their position at some point.

Public disclosure is likely to reduce liquidity, the efficiency of price discovery, competition, and capital formation, and increase market volatility.

We strongly believe that public disclosure of individual short positions would reduce pricing efficiency and raise volatility, as supported by initial studies on the impact of short-selling public disclosure regimes.[23] First, as noted above, we believe that in many cases, information on short positions is likely to be misinterpreted if publicly disclosed and may lead to "copycat" investor behaviour which itself exacerbates pricing volatility.

Secondly, and we feel the primary objective behind public attribution of short-selling, public disclosure of individual short positions will cause potential short sellers to either refrain from or minimize engaging in short sales by reducing incentives to develop trading strategies that use short selling, or to reduce their short sale transactions to avoid triggering any threshold for requiring public disclosure. This reduction in short selling activity will adversely affect liquidity and pricing efficiency. If a public disclosure requirement causes investors to avoid short selling strategies or to artificially reduce their level of short selling to remain below a disclosure threshold, as anticipated, the disclosure requirement would lead to diminished pricing efficiency in our markets. This would result in increased costs for all equity market participants. Institutional and retail investors alike would also experience increased transaction costs (i.e. wider bid-ask spreads) and longer times to fill orders.

Thirdly, as liquidity decreases as a result of reduced short selling activity, volatility is likely to increase and impair investor confidence. While many factors impact capital formation, none do so more than investor confidence, liquidity and stability. Accordingly, we believe public disclosure is likely to have far-reaching effects and impair our markets in many respects, including the ability of public companies to raise capital.

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[23] *See* The effects of short-selling public disclosure regimes on equity markets, A comparative analysis of US and European markets, Oliver Wyman, 2010; The effects of short selling public disclosure of individual positions on equity markets, Oliver Wyman, February 2011.

C. Reporting to Regulators Only

Short sale position reporting should be to Regulators only.

For the reasons set out above, we believe if the Commission or policy makers determine short sale position reporting to be necessary that short positions should only be reported on a confidential basis to regulators. Private reporting would protect investors' trading and risk management strategies and avoid a chilling effect on the benefits short selling provides to markets, including enhancing liquidity, increasing market efficiency and facilitating price formation.

We believe the Commission should assess through its experience with Form SH whether individual short position reporting was beneficial in supporting its market oversight responsibilities. We are not convinced that individual short position reporting would deter potential market manipulators as such bad actors would most likely not report their positions to the Commission. Also, without market context, it may be difficult for the Commission to identify manipulation through short position reports. We believe a more effective and efficient method of overseeing the markets is for the Commission and self-regulatory organizations, as they currently do, to analyse market data for aberrant or suspicious trading—both on the long and short side—and to retrieve such trades from broker-dealers for investigation.

D. Defining Short "Position"

Short positions should be calculated by reference to an investor's net economic short position.

With respect to the Commission's questions on defining "position", we believe that individual reporting or disclosure on the basis of an investor's short physical position reduced by any long exposures in the same issuer is likely to be more meaningful to regulators than information excluding offsetting long positions. In this way, regulators will be able to assess whether an investor is genuinely short. We believe indices and baskets should be excluded from the calculation, however, as these instruments are difficult to deconstruct for calculation purposes.

E. Exemptions from Short Sale Position Reporting

We consider that, if there are to be any exemptions for market making or liquidity providing activity, the Commission should take into account the effect of advances in technology and changing market structures which have led to a growing range of types of entity and roles within the market which act to improve liquidity and aid price discovery and the potential competitive advantage given to those who benefit from the exemption over other market participants.

On the other hand, the Commission should consider that for data to be useful to any user, including monitoring for abusive behavior, it must be encompassing and contain no exceptions from reporting. Exceptions from reporting would make it very difficult for a user to draw conclusions, and would increase the risk for abuse to avoid reporting requirements. We believe information would be most helpful to the Commission if short sales were reported in an aggregated format, on a gross basis, regardless of the rationale for the short including arranged financing transactions, as a net number at the end of the day.

F. Experiences with Short Sale Position Reporting in Foreign Jurisdictions

Experiences in Europe with short sale position reporting regimes provide insufficient evidence to support public disclosure.

The short sale position reporting rules in Europe have only applied to a narrow range of financial stocks, for a relatively short period and in exceptional market conditions. It is difficult to extrapolate from this experience reliably to confirm the absence of likely adverse effects from extending such a regime more broadly. One significant observation, however, in comparing the effect of the UK regulatory regime, which required public disclosure of short interest in financial stocks, to the U.S. was that liquidity in the affected stocks was better over this period in the U.S. markets, and bid-ask spreads were significantly tighter.[24] (*See also* Appendix A: US Financials Index vs. UK Financials Index.) We know that some MFA members have reduced their participation in foreign markets as a result of the jurisdiction's introduction of public disclosure regimes for short selling.

It is also important to note that the regulatory regimes in Europe lack a locate and short sale marking framework, as exists in the U.S., which is vastly superior for deterring and enforcing market abuse relating to short selling. The Reg SHO framework is a more focused and efficient way of gathering information about short positions, and with some enhancement, investment firms would likely be able to provide regulators with real-time information.

V. Transaction Reporting

In general, the comments and concerns we raised with respect to real-time reporting of individual short positions are equally applicable to short sale transaction marks to a Consolidated Tape ("transaction reporting"). We believe that adding short sale transaction marks to the Consolidated Tape would likely add a lot of noise in the amount of data provided to the public, but would be of little benefit for the great majority of investors. The amount of short sale information would be too voluminous for the general public to understand, especially as the majority of short sales are used as part of a hedging strategy. Only a handful of highly sophisticated market participants who are able to use technology to analyze the data would likely be able to make use and benefit from short sale transaction reports on the Consolidated Tape.

The costs to implement a Pilot program are likely to be extremely high in terms of the level of complexity, time and expense it would take to reprogram market-wide systems to mark orders "short sale", "market maker short" and "buy-to-cover". We defer to self-regulatory organizations and broker-dealers on estimates on cost. We believe it would be more cost-

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[24] *Id.*

effective for the Commission to have exchanges provide aggregate, end-of-day transaction reports as part of a Pilot program.

VI. Conclusion

MFA opposes market manipulation of any kind and actively supports initiatives to improve and enhance the functioning of our markets and to combat manipulation. Such efforts would result in greater liquidity and improved investor confidence. We do not believe, however, that the real-time short sale reporting or transaction reporting proposals would benefit the general public by improving understanding for short selling or market activity, investor confidence or preventing abusive or manipulative activity in connection with buying or selling securities. In fact, we cannot determine any additional benefits from such proposals. Individual public short reporting, though, would be costly to implement and would significantly and negatively impact the markets, as well as likely introduce new types of disruptive market activity.[25]

We would be happy to further discuss the proposals or other market initiatives with the Commission or its staff. If you have questions or comments, please do not hesitate to contact Jennifer Han or the undersigned at (202) 730-2600.

Respectfully submitted,

/s/ Stuart J. Kaswell

Stuart J. Kaswell
Executive Vice President & Managing Director,
General Counsel

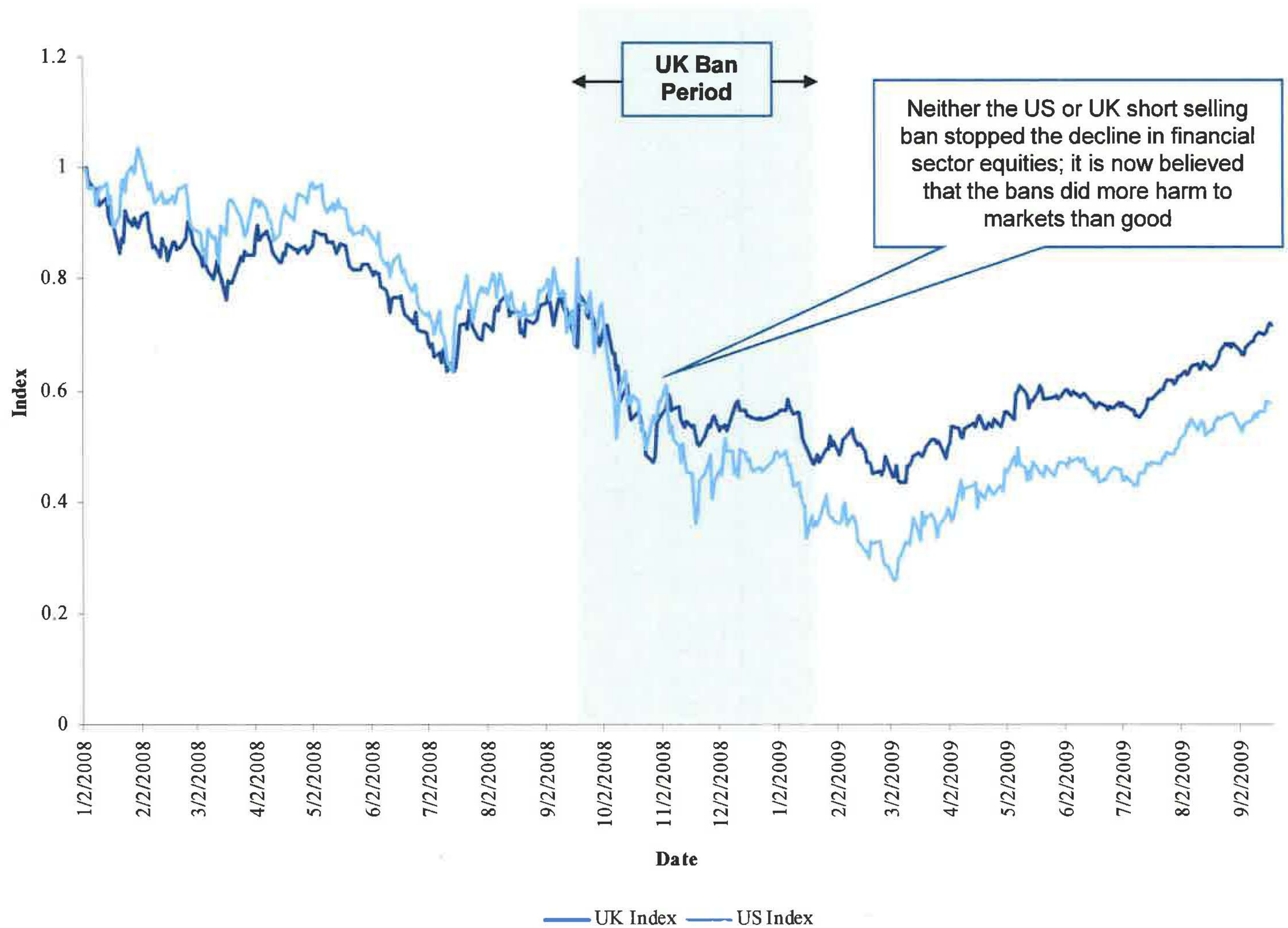
cc: The Hon. Mary Schapiro, Chairman
The Hon. Kathleen L. Casey, Commissioner
The Hon. Elisse B. Walter, Commissioner
The Hon. Luis A. Aguilar, Commissioner
The Hon. Troy A. Paredes, Commissioner

[25] Such requirements would raise questions under Section 3(f) of the Securities Exchange Act of 1934, which provides:

> Whenever pursuant to this title the Commission is engaged in rulemaking, or in the review of a rule of a self-regulatory organization, and is required to consider or determine whether an action is necessary or appropriate in the public interest, the Commission shall also consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.

Appendix A

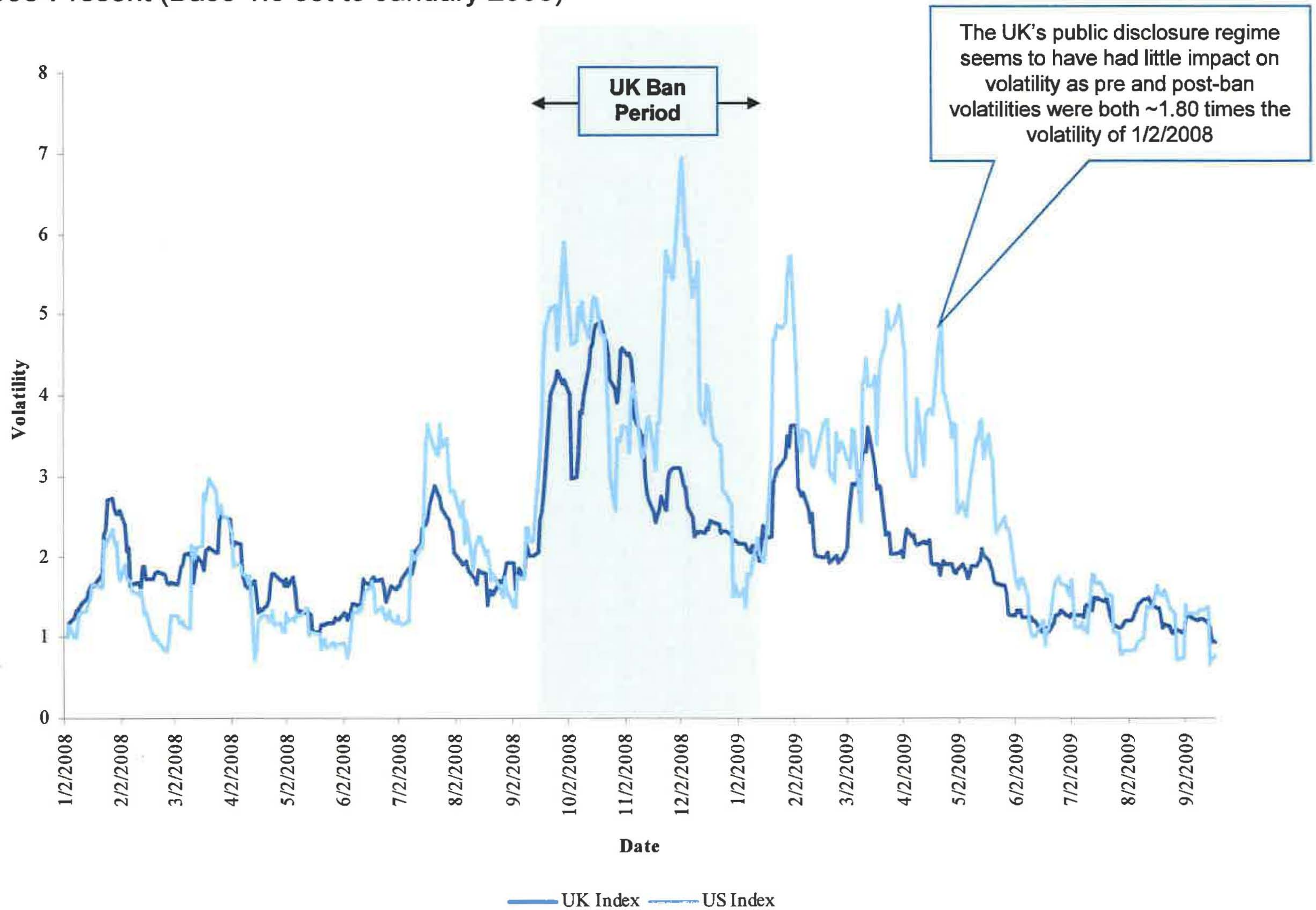
US Financials Index vs. UK Financials Index
2008-Present (Base 1.0 set to January 2008)



Source: Bloomberg

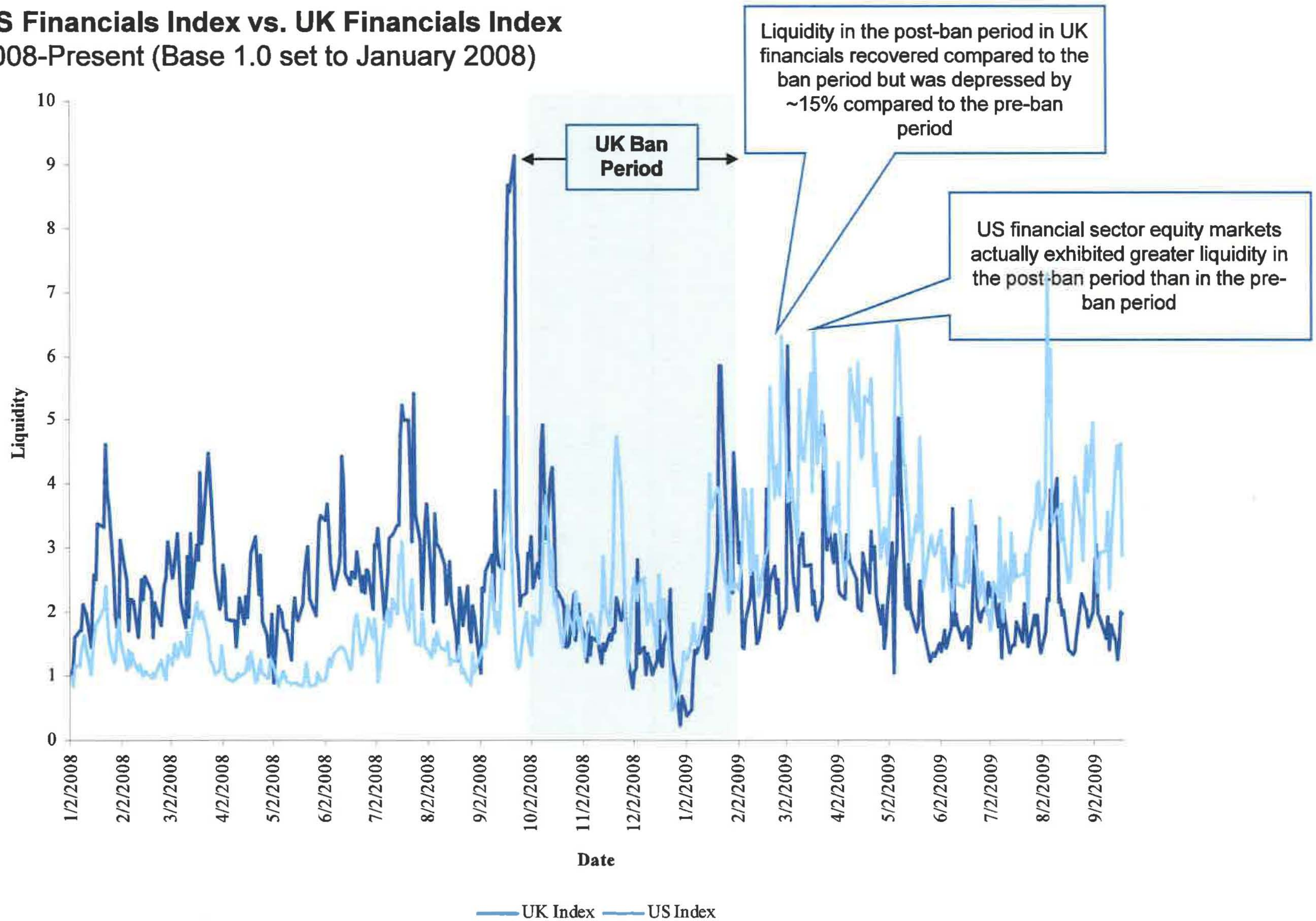
US Financials Index vs. UK Financials Index

2008-Present (Base 1.0 set to January 2008)



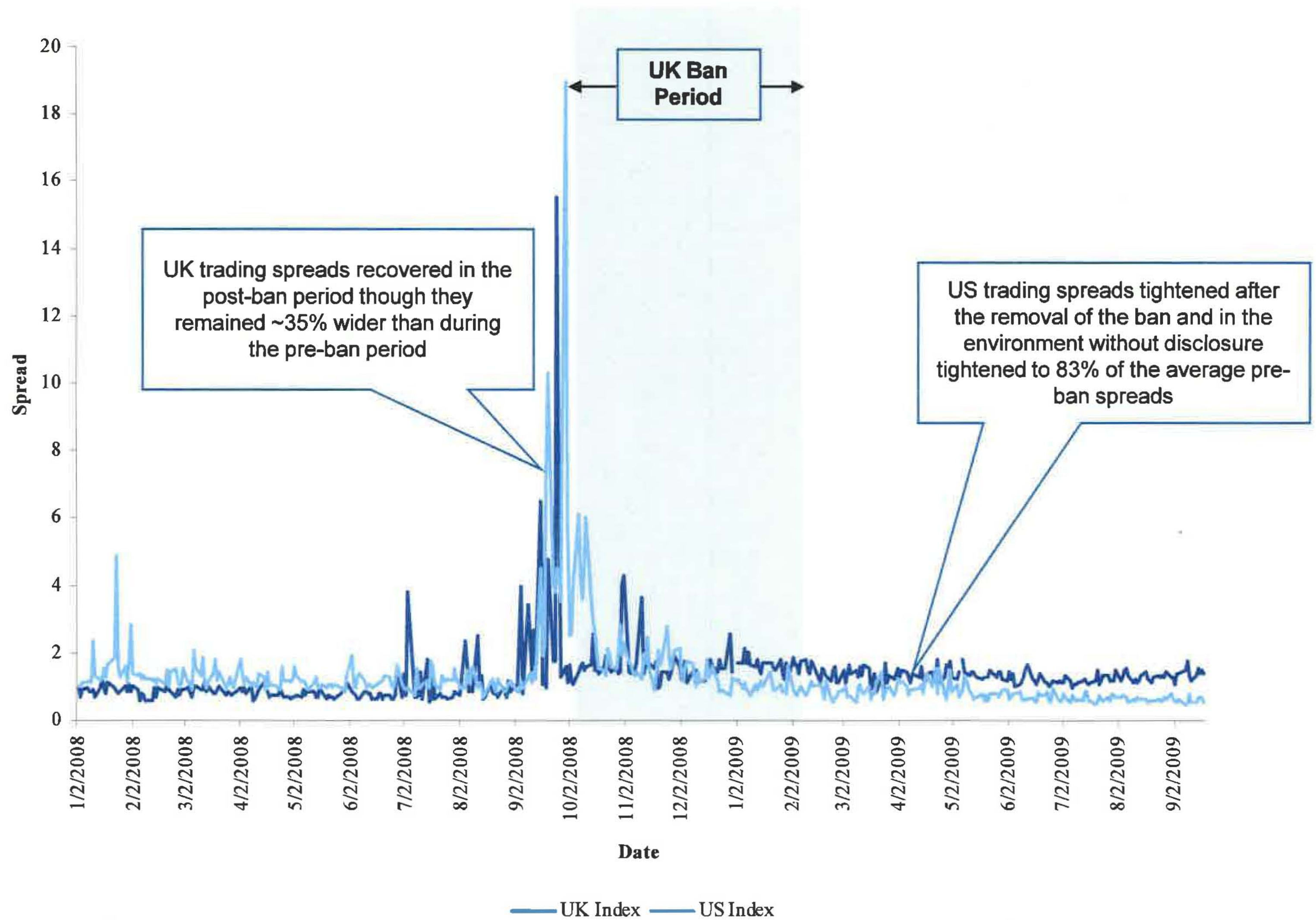
Source: Bloomberg

US Financials Index vs. UK Financials Index
2008-Present (Base 1.0 set to January 2008)



Source: Bloomberg

US Financials Index vs. UK Financials Index
2008-Present (Base 1.0 set to January 2008)



Source: Bloomberg