June 23, 2011

By Mail and Electronic Delivery

The Honorable Mary L. Schapiro
Chairman
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: File No. 4-627; Rel. No. 34-64383
Short Sale Reporting Study Required by Dodd-Frank Act Section 417(a)(2)

Dear Chairman Schapiro:

The Coalition of Private Investment Companies ("CPIC")[1] is pleased to submit this letter to the Securities and Exchange Commission ("Commission" or "SEC") in response to the request for public comment with regard to studies required under Section 417(a)(2) of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") as to the feasibility, benefits, and costs of requiring real-time reporting (whether publicly or only to regulators) of short sale positions of publicly listed securities, and of conducting a voluntary pilot program in which public companies would agree to have all trades of their shares marked and reported with new short-sale related designations.[2] In this letter and in our responses to the studies' specific questions, we make the following points:

The Commission must base its policy decisions on empirical evidence. The Commission historically based its regulation of short selling on empirical evidence and after deliberate review. It appeared to depart from this policy during the financial crisis, with results that were harmful to investors and the markets. We hope that with the current studies, the Commission will take a measured approach to assessing whether there are problems in the marketplace resulting from short selling that must be addressed by new regulatory requirements.

Regulators must define a problem before imposing a solution. In its request for comment, the Commission did not identify any specific market abuses from short selling

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[1] CPIC is a coalition of private investment companies who are diverse in size and in the investment strategies they pursue. Established in 2005, CPIC informs policy-makers, the media, and the public about the private fund industry and its role in the capital markets.

[2] *See* Rel. No. 34-64383, *Short Sale Reporting Study Required by Dodd-Frank Act Section 417(a)(2)*, 76 Fed. Reg. 26787 (May 9, 2011), *available at* http://www.gpo.gov/fdsys/pkg/FR-2011-05-09/pdf/2011-11188.pdf (hereinafter the "Release").

that are not addressed under current regulation and that therefore warrant the additional reporting or data dissemination requirements that are the subject of the Commission's questions.

An enormous volume and range of short sale data is currently available to the public, and the Commission can obtain whatever information it needs from regulated entities, such as broker-dealers and hedge fund advisers, for regulatory purposes. There appears to be no justification for adding new, burdensome and costly reporting requirements for short sales.

Disclosures of individual short sale positions may unfairly reveal proprietary information and undermine market quality. If the Commission were to require public reporting of individual investors' specific short selling transactions or holdings, other traders could then "free ride" by mimicking their strategies without the investment of research, and short sellers would also be exposed to retaliatory actions, such as civil litigation or opportunistic short squeezes. In constraining short selling, directly or indirectly, the Commission would weaken an activity that enhances market quality for investors by deepening liquidity, narrowing spreads, promoting price discovery, and, as confirmed by academic research, mitigating market bubbles.

Until definitions of core concepts – "position" and "real time" – are defined, it is difficult to identify all issues that would arise from gathering and disseminating information on short transactions and positions. Depending on whether a "position" is defined to refer to aggregate short holdings by volume and/or dollar, a netting of long and short holdings in equity, or a netting of positions across all holdings (whether in equity, convertible securities, derivatives, etc.), the consequences of reporting will vary. Meeting demands in real time adds even more challenges, given that the transactions involved in establishing or unwinding short positions may occur at different times over a period of time.

I. Background.

The proposals to require real time short sale position reporting and to require new short sale transaction designations appear to be designed to suppress short sellers – in this case by adding new regulatory burdens on short sellers and exposing short sellers to both potential retaliation and the loss of their intellectual property. While the Commission historically recognized the benefits of short selling to the markets and rejected efforts to deter it, the Commission's position shifted during the last several years, as it took a number of unprecedented steps aimed at halting the market's steep decline in 2008. During this recent period of market stress, the steps the Commission took to curb short selling actually worsened market quality by reducing liquidity, raising investors' transaction costs and reducing price discovery.

Blaming short sellers is a routine reaction whenever the market takes a major correction. Indeed, after the crash of 1929, the first Congressional proposals for market regulation were aimed primarily at restricting short selling.[3] Yet the claims of short-sale critics were refuted when the facts came out,[4] and most efforts to restrict short selling thereafter failed, due to the lack of any empirical evidence suggesting that steep market drops or even steep drops in the stock prices of individual issuers were caused by short selling.

The Commission periodically has reviewed its position on short selling, but the results have consistently been the same: short selling is good for the markets, and critics' complaints are unfounded. Numerous studies and government inquiries have borne this out.[5] For example, former SEC Commissioner Irving Pollack observed in his 1986 report *Short-Sale Regulation of NASDAQ Securities*, "short sales . . . came to be recognized as essential to the efficient functioning of securities markets."[6] Congress examined short selling as part of its investigation following the sudden and severe market drop of 1987, and not only was short selling exonerated from having any role in the market's steep decline, it was identified as a valuable tool for U.S. securities markets. At hearings in 1989, the Director of the Commission's Division of Market Regulation told Congress that short selling "provide[s] the market with two vital benefits: market liquidity and pricing efficiency."[7] The Associate Director of the Commission's Enforcement Division also explained that short sellers were often the discoverers, and not the perpetrators, of illegal behavior:

> [T]he Commission has found occasions where short sellers have detected corporations which are engaged in violations of the securities and other laws themselves in order to inflate the value of their securities. When we have sustainable evidence of this type of violation, we will bring that case as well.[8]

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[3] Joel Seligman, THE TRANSFORMATION OF WALL STREET, 9 (Houghton Mifflin 1982).

[4] For example, New York Stock Exchange economist Edward Meeker published *Short Selling* in 1932, in which he debunked the myth that bear traders were to blame for the 1929 market crash. Meeker's research concluded that there was no indication that bear raids contributed to the collapse, that short interest in the market at the time of the crash was minimal (approximately 0.01% of outstanding shares), and that large block sales and forced sales by margin traders were more likely to blame for the market's fall. *Id.*

[5] Studies were conducted in 1935 and 1951 by the Twentieth Century Fund, and in 1937, 1963, and 1976 by the Commission. *Id.* at 29-33.

[6] Irving M. Pollack, SHORT SALE REGULATION OF NASDAQ SECURITIES, 20 (1986).

[7] *Short-Selling Activity in the Stock Market: The Effects on Small Companies and the Need for Regulation: Hearing Before the Subcomm. on Commerce, Consumer, and Monetary Affairs of the H. Comm. on Government Operations*, 101st Cong. 385 (1989) (statement of Richard G. Ketchum, Dir., Div. of Market Regulation, SEC).

[8] *Id.* at 392 (statement of John H. Sturc, Assoc. Dir., Div. of Enforcement, SEC).

In 2003 hearings, Congress again reviewed short selling amid allegations by certain groups that short sellers and plaintiffs' lawyers were sharing information in order to drive down the stock of companies.[9] These allegations were rebutted by research showing "Short sellers are good at detecting and publicizing fraud on the part of firms. ... To protect investors, we need a vibrant short seller community."[10] At the same hearing, Congressman Paul Kanjorski noted that short sellers act as the market's own defense against hype and fraud.[11]

Consistent with its historical position on short selling, in 2007 the Commission completed an eight-year series of studies and pilot programs on the "tick test" of Rule 10a-1. The study included extensive data gathering and analysis by the Commission's Office of Economic Analysis ("OEA"). The OEA concluded that there was "little empirical justification for maintaining price test restrictions, especially for large securities."[12] As a result, the Commission repealed Rule 10a-1 in July 2007.

In 2008, however, the Commission departed from its prior positions on short sale regulatory policy. In July of that year, in response to repeated calls to the Commission by various investment bankers, including Lehman Brothers CEO Richard Fuld, the Commission, by emergency order, imposed pre-borrow requirements on short sales of the securities of two government-sponsored enterprises and seventeen primary dealers.[13] In September, again under pressure from large financial holding companies, as well as Treasury Secretary Paulson and other financial regulators, the Commission banned short sales in the securities of "financial" firms, and then allowed listing exchanges to determine if an issuer was "financial"[14] – ultimately resulting in a ban on short sales covering almost 1000 issuers. As a result of the ban, liquidity dried up, volatility increased, spreads

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[9] *The Long and Short of Hedge Funds: Effects of Strategies for Managing Market Risk: Hearing before the Subcomm. on Capital Markets, Insurance, and Government Sponsored Entities of the H. Comm. on Fin. Services*, 108th Cong. 28-30 (2003) (statement of Paul Kamenar, Senior Executive Counsel, Washington Legal Foundation).

[10] *Id.* at 34 (statement of Owen Lamont).

[11] *Id.* at 46-47 (statement of the Honorable Paul Kanjorski).

[12] Proposed Rule, *Amendments to Regulation SHO and Rule 10a-1*, Rel. No. 34-54891 (Dec. 7, 2006), 71 Fed. Reg. 75,068, 75,073 (Dec. 13, 2006) (footnotes omitted), *available at* http://sec.gov/rules/proposed/2006/34-54891fr.pdf.

[13] Rel. No. 34-58166, *Emergency Order Pursuant to Section 12(k)(2) of the Securities Exchange Act of 1934 Taking Temporary Action to Respond to Market Developments* (Jul. 15, 2008), *available at* http://www.sec.gov/rules/other/2008/34-58166.pdf.

[14] Rel. No. 34-58592, *Emergency Order Pursuant to Section 12(k)(2) of the Securities Exchange Act of 1934 Taking Temporary Action to Respond to Market Developments*, *available at* http://www.sec.gov/rules/other/2008/34-58592.pdf (Sept. 18, 2008); Rel. No. 34-58611, *Amendment to Emergency Order Pursuant to Section 12(k)(2) of the Securities Exchange Act of 1934 Taking Temporary Action to Respond to Market Developments* (Sept. 21, 2008), *available at* http://www.sec.gov/rules/other/2008/34-58611.pdf.

widened, price discovery was undermined, trading strategies were impeded, investment firms were forced to limit offerings, and the prices of financial stocks continued to plummet.[15] SEC Chairman Christopher Cox later admitted that the extraordinary three-week ban on short selling was the biggest mistake of his tenure, and he agreed to it only as a result of pressure from the Treasury Department and others who panicked in the face of the market's steep decline. In addition to the ban, the Commission issued a temporary rule in October 2008 requiring certain investment managers to file reports of short sales with the Commission on temporary Form SH.[16]

These actions followed on the heels of the Commission's very public and wide-ranging enforcement initiative to investigate and identify abusive short sellers. In July 2008, with a press release stating that it was investigating rumor-mongering and abusive short sales, the Commission sent subpoenas and investigators to numerous broker-dealers and investment managers' offices to gather evidence of alleged abusive activity.[17] But in the end, the Commission brought no charges against short sellers as a result of this massive investigation. In fact, Chairman Schapiro testified before the Financial Crisis Inquiry Commission in 2010, saying, "We do not have information at this time that manipulative short selling was the cause of the collapse of Bear and Lehman or of the difficulties faced by other investment banks during the fall of 2008."[18] As stated in the Lehman Bankruptcy Examiner's report, Lehman was actually undone by the misdeeds of its management,

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[15] *See* Don Autore, Randall Billingsley, and Tunde Kovacs, *The 2008 Short Sale Ban: Liquidity, Dispersion of Opinion, and the Cross-Section of Returns of U.S. Financial Stocks*, Jan. 19, 2011, *available at* http://ssrn.com/abstract=1422728; Seraina Gruenewald, Alexander Wagner, and Rolf Weber, *Emergency Short Selling Restrictions in the Course of the Financial Crisis*, June 22, 2010, *available at* http://ssrn.com/abstract=1441236; Emilios Avgouleas, *A New Framework for the Global Regulation of Short Sales: Why Prohibition is Inefficient and Disclosure Insufficient*, Stanford Journal of Law, Business, and Finance, Vol. 16, No. 2, 2010, *available at* http://ssrn.com/abstract=1411615; Warren Bailey and Lin Zheng, *Banks, Bears, and the Financial Crisis*," Oct. 23, 2010, *available at* http://ssrn.com/abstract=1695062 (concluding that "short sales did not contribute significantly to this crisis, and efforts to constrain short-selling are misguided.").

[16] Rel. No. 34-58591, *Emergency Order Pursuant to Section 12(K)(2) of the Securities Exchange Act of 1934 Taking Temporary Action to Respond to Market Developments* (Sept. 18, 2008), *available at* http://www.sec.gov/rules/other/2008/34-58591.pdf; Rel. No. 34-58591A, *Amendment to Emergency Order Pursuant to Section 12(k)(2) of the Securities Exchange Act of 1934 Taking Temporary Action to Respond to Market Developments* (Sept. 21, 2008), *available at* http://www.sec.gov/rules/other/2008/34-58591a.pdf; Rel. No. 34-58724, *Order Amending and Extending Emergency Order Requiring Institutional Money Managers to Report New Short Sales* (Oct. 2, 2008), *available at* http://www.sec.gov/rules/other/2008/34-58724.pdf; Rel. No. 34-58785, *Interim Final Temporary Rule – Disclosure of Short Sales and Short Positions by Institutional Investment Managers* (Oct. 15, 2008), *available at* http://sec.gov/rules/final/2008/34-58785.pdf.

[17] SEC Press Release 2008-140, *Securities Regulators to Examine Industry Controls Against Manipulation of Securities Prices Through Intentionally Spreading False Information* (Jul. 13, 2008), *available at* http://www.sec.gov/news/press/2008/2008-140.htm.

[18] Report of the Financial Crisis Inquiry Commission, at 327, *available at* http://fcic-static.law.stanford.edu/cdn_media/fcic-reports/fcic_final_report_full.pdf.

which included, among other things, manipulating its balance sheet to make it appear less leveraged than it really was.[19]

The Commission's actions to suppress short selling in 2008 increased volatility,[20] disrupted markets in general,[21] and gave unwarranted legitimacy to a common

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[19] *See Report of Anton Valukas, Examiner,* In re Lehman Brothers Holdings, Inc., Chapter 11 Case No. 08-13555 (JMP) (Bankr. S.D.N.Y., Mar. 11, 2010) [hereinafter *Examiner's Report*], Introduction at 6-7, Section I at 18-20, and Section III.A.4, at 739, 962-963, *available at* http://lehmanreport.jenner.com. The report states that "unbeknownst to the investing public, rating agencies, Government regulators, and Lehman's Board of Directors, Lehman reverse engineered the firm's net leverage ratio for public consumption." *See* Section III.A.4. at 739. The report also states that the "sole function [of Repo 105 transactions] as employed by Lehman was balance sheet manipulation." *See* Section I at 18. The report further states that Lehman's own accounting personnel described Repo 105 transactions as an "accounting gimmick" and a "lazy way of managing the balance sheet as opposed to legitimately meeting balance sheet targets at quarter end." *See* Section I at 18 and Section III.A.4 at 743, 869.

[20] Commentators noted the global crackdown on short selling made markets more volatile. *See* Jonathan Spicer, *Short Ban Seen Exacerbating Sharp Market Drop*, Reuters, Sept. 30, 2008, *available at* http://www.reuters.com/article/ousiv/idUSTRE48T7PT20080930. *See also* Seth Freedman, *We've Been Sold Short*, The Guardian, Oct. 17, 2008 ("The S&P 500 index lost 21.5% of its value during the period of the ban, and the embargo was viewed by market experts as actually increasing volatility in the indices."), *available at* http://www.guardian.co.uk/commentisfree/2008/oct/17/shortselling-creditcrunch. A Nasdaq OMX study found that stocks covered by the ban became more volatile. *See* David Greising, *Short-Selling Ban Leaves SEC With Little to Show*, Chicago Tribune, Oct. 10, 2008, *available at* http://articles.chicagotribune.com/2008-10-10/news/0810090731_1_ban-financial-stocks-short-selling. The Chicago Board Options Exchange Volatility Index (a widely used measure of market volatility) set new records during the ban. *See* Jeff Kearns, *VIX Jumps to Record, Topping 56, on `Mad Rush' to Sell Assets*, Bloomberg, Oct. 6, 2008, *available at* http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aY49QquT09lU&refer=home; Spicer, *supra.*

[21] As academics and researchers found regarding the ban on short sales of financial stocks:

Liquidity Dried Up. Liquidity diminished, as buyers who usually hedged investments with short sales and other traders left the market. The Wall Street Journal noted that "[b]etween Sept. 22 and Sept. 29, overall trading volumes fell 41.1% from the week of Sept. 15-19, ... [and] volume in the restricted stocks was down 49.6%." Tom Lauricella et al., *SEC Extends "Short" Ban as Bailout Advances*, Wall St. J., Oct. 2, 2008, at C1; *see also* James Mackintosh, *Short Shrift*, Financial Times, Oct. 5, 2008.

Spreads Widened Dramatically. The Wall Street Journal also reported that, as may be expected from lost liquidity, spreads in restricted stocks rose sharply — from 0.15 to almost 0.40 percentage points. Lauricella, Scannell and Tracy, *supra*; *see also* Mackintosh, *Short Shrift, supra;* Louise Story, *A Debate as a Ban on Short-Selling Ends: Did It Make Any Difference?*, N.Y. Times, Oct. 8, 2008, at B8 (noting spreads on financial stocks increased by 42 percent).

Legitimate Trading Strategies, Including Long Trades, Were Impeded. The ban severely limited the ability of traders to rely on strategies such as convertible arbitrage. According to data provider Hedge Fund Research, convertible arbitrage, which involves hedging a convertible bond purchase by shorting the underlying shares, fell by 16.3% between September 22 and September 28. *See* David Walker, *Short-Selling Is Down But Not Out As Industry Fights Back*, Dow Jones Financial News, Sept. 29, 2008. Due to the ban, there was less interest in buying convertible bonds, which tends to increase the cost of capital for issuers. *See* Alistair Barr, *Short-Sale Ban Disrupts Trades For Hedge Funds, MarketWatch*, Sept. 26, 2008, *available at*

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misperception that short sellers exert powerful and detrimental forces in the market.[22] In April 2009, the Commission, under a new Chairman, proposed, and then in February 2010 adopted, new short sale restraints.[23] The Commission took this action, while acknowledging that (1) there was no evidence that the lack of an uptick rule contributed to the steep declines in stocks in 2008, (2) short volume was only a small percentage of overall trading during the market's decline in 2008, and (3) price pressures on financial stocks came from long selling and not short selling. The Commission nonetheless explained that it adopted the new rules to restore investor confidence. In opposing the rule, Commissioner Casey stated that the Commission's release suggested "that short selling vis-à-vis long selling is less legitimate or even illegitimate and should be restricted if it results in price declines."[24]

The Present Study on Short Sale Reporting and Transaction Marking.

Neither the statute directing the pending study, nor the Commission's request for comment, identifies any abuses that short sale reporting or transaction marking would help to address. Yet, some of the questions are framed in a way that suggests the Commission may believe that that there are short sale abuses that it has yet to identify, but which could be revealed if short positions and/or short transactions were reported in more detail and, in some cases, disseminated in real time for public scrutiny. The Commission will need to identity the abuses that warrant additional reporting requirements beyond those already required and beyond what existing market surveillance systems can detect.

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http://www.marketwatch.com/news/story/hedge-funds-suffer-short-selling/story.aspx?guid=%7BA12A0C0D-55FF-4576-9F2B-9D4C9072200E%7D&dist=msr_1).

Stock Purchases Were Hindered. The ban prevented investors from using short sales to hedge, thus discouraging them from taking on new long positions. *See* Barr, *supra.*

[22] For example, a paper submitted to the Department of Defense asserts that "a series of bear raids targeting U.S. financial services firms" was part of an attack by terrorists against the U.S. economy. Kevin Freeman, Cross Consulting and Services, *Economic Warfare: Risks and Responses,* at 1-2 (June, 2009), *available at* http://www.scribd.com/doc/49755779/Economic-Warfare-Risks-and-Responses-by-Kevin-D-Freeman. Notwithstanding Chairman Schapiro's confirmation that there is no evidence of such bear raids, some commenters on the present study still rely on the claim (*see e.g.* Letter dated May 19, 2011 from Jonathan Johnson, CEO, Overstock.com, *available at* http://www.sec.gov/comments/4-627/4627-110.pdf). A 1991 Report by the House Committee on Government Operations found that "the psychological environment surrounding short selling has led investors to systematically overestimate the manipulative power of short sellers." Short-Selling Activity in the Stock Market: Market Effects and the Need for Regulation (Part 1) (House Report), H.R. Rep. No. 102-414 (1991), *available at* 1991 WL 262146.

[23] Rel. No. 34-61595, *Amendments to Regulation SHO* (Feb. 26, 2010), 75 Fed. Reg. 11232 (Mar. 10, 2010), *available at* http://sec.gov/rules/final/2010/34-61595fr.pdf.

[24] *Statement at Open Meeting on Short-Sale Restrictions* by Commissioner Casey (Feb. 24, 2010), *available at* http://www.sec.gov/news/speech/2010/spch022410klc-shortsales.htm.

Until the Commission defines a problem that position reporting or transaction marking may address that existing systems cannot, it is difficult to offer solutions. To illustrate, the Commission has yet to publish any evidence that demonstrates how a short position based on a valuation of an issuer's fundamentals has adversely affected the marketplace, and how reporting that position would have addressed the harm. The Commission required investment managers to report short positions from September 2008 until August 2009, and therefore has approximately a year's worth of reports disclosing short positions in securities on hand for its review and analysis. However, the Commission has neither described what it learned from reviewing these reports, nor stated whether the data it obtained was useful for any purpose.

On the other hand, numerous academic studies have demonstrated that constraining short sales undermines market quality while narrowing the opportunities for investors to earn returns on their capital and manage their risks effectively. As explained further below, if the Commission requires investors to disclose short positions, investors may limit their short selling activities and deprive the markets of the benefits they bring. Investors would be penalized by the imposition of new opportunity costs on their ability to hedge risks and pursue investment strategies to enhance returns on their capital.

II. Responses to Questions.

In the Release, the Commission has set forth a number of specific questions. Our responses to those questions are set forth below.

Baseline Questions.

Q1. How are currently available data used by issuers, market participants, and others (such as SROs, data vendors, media, analysts, and academics) today? How widely distributed are currently available data? Do costs or other factors limit access to currently available data? Are there other important sources of information as to short sales and short sale positions in addition to those mentioned [in the Release]?

The Commission and self-regulatory organizations ("SROs") obtain short sale information from broker-dealers, traders, asset managers and others if and as needed for market surveillance and other purposes. There is virtually no limit to the information the Commission may obtain from any regulated entity, including registered brokers and investment advisers (such as advisers to hedge funds).

A tremendous amount of data regarding short sales is already widely available online to the public at no cost or through news services and other data vendors for a fee. A number of trading centers and SROs make short sale volume and transaction data publicly available on their websites. For example:

- Every day, the BATS Exchanges post free, publicly available files on their website containing information regarding every short sale executed on the exchanges that day. These files disclose aggregate daily short sale volume and total volume by security. They also include details for each short sale, including security, date, time, price, and size and indicate whether a market maker was involved in the transaction.[25]

- The Direct Edge Exchanges' website also posts free daily files that show aggregate daily short sale volume and total volume by security for each trade executed on the exchanges that day (excluding orders routed to other market centers and odd lot executions). Direct Edge also posts free files on its website that include details for each such short sale, including security, date, time, price, and trade size.[26]

- The New York Stock Exchange ("NYSE") makes the following short sale data publicly available in exchange for fees:[27]

  - NYSE Short Sales: a monthly product that contains symbol, volume, and time of execution for the month's short sales at the NYSE and NYSE Amex. Data on delivery failures under Reg SHO is also included.[28]

  - NYSE Group Short Interest: a semi-monthly report of uncovered short positions of securities listed on NYSE, NYSE Arca and Amex. This report is derived from data required to be supplied by broker-dealers under exchange rules. It includes the previous month's position and the average daily volume of all NYSE, NYSE Arca and NYSE Amex issues.[29]

  - NYSE Volume Summary: a daily summary of NYSE and AMEX trading activity broken down by symbol, date, short volume, total volume, number of trades, odd-lot volume, and volume weighted average price. NYSE and Amex Reg SHO Adjusted Short Sales are included.[30] NYSE Arca Reg SHO Short Volume is supplied by NYSE Arca, Inc.[31]

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[25] *See* http://batstrading.com/market_data/shortsales/.

[26] *See* http://www.directedge.com/Regulation/ShortSaleReports.aspx.

[27] *See* http://www.nyxdata.com/Data-Products/Equities.

[28] *See* http://www.nyxdata.com/Data-Products/NYSE-Short-Sales. The fee for this data is $500 per month.

[29] *See* http://www.nyxdata.com/Data-Products/NYSE-Group-Short-Interest. The fee is $400 per month.

[30] *See* http://www.nyxdata.com/Data-Products/NYSE-Volume-Summary. The fee is $100 per month.

[31] *See* http://www.nyse.com/regulation/nyse/1114512102403.html.

- NYSE also posts lists of Reg SHO "threshold securities" for every settlement date at no cost.[32]

- NASDAQ OMX makes the following data available for short sales in both listed and unlisted shares on the NASDAQ Stock Market, as well as the NASDAQ OMX BX and NASDAQ OMX PSX market systems:

  - Daily Short Sale Volume: includes the per-security aggregate volume of short sales and total volume traded during regular trading hours.

  - Monthly Short Sale Transactions: a trade-by-trade record of all short sales executed on these markets and reported to the consolidated tape, including transaction time, price and number of shares for every short sale transaction.

  - Short Interest Report: a semi-monthly summary of the consolidated market short interest in all NASDAQ-listed securities.[33]

  - Short interest on a security-by-security basis is also available free of charge.[34]

- The Financial Industry Regulatory Authority ("FINRA") makes publicly available on-line daily short sale volume files and monthly short sale transaction files at no cost.[35] These daily files provide the total volume, aggregate short and short exempt volume by security on all short sale trades executed and reported to a FINRA reporting facility during normal market hours for that day. The monthly files provide detailed trade activity of each short sale reported to the consolidated tape per security, including transaction times, price, number of shares and whether the sale was short exempt.

- FINRA member firms must report total short positions in all of their customer and proprietary firm accounts in all equity securities twice per month through FINRA's Web-based Regulation Filing Application system.[36] This short interest data is released by exchanges that list those stocks, or by FINRA where the stock is not listed, after eight business days.[37]

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[32] *See* http://www.nyse.com/regulation/nyse/Threshold_Securities.shtml?date=20110602.

[33] *See* http://www.nasdaqomxtrader.com/Trader.aspx?id=shortsale. The fee for this data is $500 per month.

[34] See http://www.nasdaqomxtrader.com/Trader.aspx?id=shortinterest.

[35] *See* www.finra.org/trf/regsho and www.finra.org/adf/regsho.

[36] *See* FINRA Rule 4560.

[37] NASDAQ Short Interest Publication Schedule, *available at* http://www.nasdaqtrader.com/Trader.aspx?id=ShortIntPubSch; NASD Notice to Members 06-14, *Short*

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- The National Stock Exchange also posts free daily short sale volume files and monthly short sale transaction files on its website. The daily files include short, short exempt and total volume data, sorted by symbol. The monthly files include transaction data, including date, time, size and price for every short sale executed and reported to the consolidated tape.[38]

- The Chicago Stock Exchange website posts short sale transactional data for all securities traded on the exchange on a monthly basis. The data includes symbol, date and time of execution, size and price and shows whether the sale was short exempt.[39]

The Commission publishes on its website twice-monthly data on fails to deliver for all equity securities.[40] Websites of the SROs also include lists of Reg SHO "threshold" securities (in brief, those where for five consecutive settlement days: (1) there are aggregate fails to deliver at a registered clearing agency of 10,000 shares or more per security; and (2) the level of fails is equal to at least one-half of one percent of the issuer's total shares outstanding for which the SRO is the primary market), for every settlement day.[41]

Stock lending data also is available from data vendors such as Data Explorers and SunGard. These vendors provide information on stock loan volume, lending costs, and the percentage of available stock out on loan. For example, Data Explorers gathers information from over 20,000 securities lending programs around the world.[42] This information can be used to gauge levels of short selling activity on an individual and market-wide basis. Data Explorers also published a list of the most-expensive stocks to borrow, which is an indicator of bearish sentiment.[43] Issuers can also subscribe for e-mail alerts from Data Explorers and Thomson Reuters whenever the amount of their stock out on loan reaches a level that they specify. The alerts even include comparisons to loan data for other stocks.[44]

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Interest Reporting Requirements (Apr. 2006), *available at* http://www.nasd.com/RulesRegulation/NoticestoMembers/2006NoticestoMembers/NASDW_016329.

[38] *See* http://www.nsx.com/content/short-sale-data.

[39] *See* http://www.chx.com/content/Trading_Information/Reg_SHO_short_sales.html.

[40] *See* http://www.sec.gov/foia/docs/failsdata.htm. This data is recorded by the National Securities Clearing Corporation ("NSCC").

[41] *See e.g., Threshold Securities - NYSE, available at* http://www.nyse.com/regulation/nyse/Threshold_Securities.shtml?date=20110602).

[42] http://www.dataexplorers.com/products/data.

[43] http://www.dataexplorers.com/news-and-analysis/most-expensive-us-shorts.

[44] http://www.dataexplorers.com/about/partners/thomson-reuters.

In addition, market participants rely heavily on financial services information providers such as Bloomberg to provide short sale data and related analytical tools. Bloomberg terminals allow investors to view short interest and changes in short interest, as well as a stock's average short interest ratio (or days to cover) updated on a daily basis. The short interest ratio is the aggregate short interest in a stock expressed as a percentage of its average daily trading volume over some preceding period, usually four weeks.[45] In general, a high short interest ratio indicates bearish sentiment. On the other hand, short interest can also be seen as a bullish indicator because it represents latent demand for purchases to cover, and can warn of the risk of a short squeeze.[46]

Thus, much information about short selling is already available to investors, issuers, market participants, academics, and regulators. This data is available in readily accessible formats, so it can be widely and quickly disseminated via print and electronic news media for public analysis. In light of the massive amount of data already available to the public, much of it free or at reasonable cost, there is little value in putting still more data into the market, particularly "real time" data, which, even if it can be reported, could be stale and meaningless virtually as soon as it is reported.

We note that broker-dealers through which short sales are placed have existing systems to report transactions on an aggregate basis. Thus, those entities are in the best position to report on short sales to the Commission and the relevant exchange; the reporting systems of those markets, in turn, can make that information available to the investing public, on an aggregate real-time basis.

Moreover, the Commission's rulemaking initiatives to enhance and document consolidated audit trails for securities transactions[47] will assist FINRA and Commission examiners and (where appropriate) their enforcement staff in detecting suspicious trading patterns and in the review of particular short-sale transactions and trading programs when suspicious patterns of trading are detected.

In addition, Title IV of the Dodd-Frank Act, which repeals as of July 21, 2011 the old "fewer than 15 clients" exemption in Section 203(b) of the Advisers Act and subjects most private fund managers to Advisers Act registration and SEC examination, was intended to give the Commission the ability to inspect investment programs of hedge funds and other private investment funds for patterns of possible manipulative trading or other fraudulent practices. In view of the detailed custody, audit, and recordkeeping requirements applicable to registered investment advisers, including private fund managers

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[45] Steven L. Jones and Glen Larsen, The Information Content of Short Sales, *in* Frank J. Fabozzi, editor, SHORT SELLING: STRATEGIES, RISKS, AND REWARDS, at 234 (John Wiley & Sons, Inc., 2004).

[46] *Id.*

[47] Proposed Rule, *Consolidated Audit Trail*, Rel. No. 34-62174, 75 Fed. Reg. 32556 (June 8, 2010), *available at* http://www.sec.gov/rules/proposed/2010/34-62174fr.pdf.

that engage in short selling, and the ability of the Commission to examine registered investment advisers, as well as existing programs for reporting short selling through broker-dealers, the Commission already has access to information on short selling needed to detect and deter manipulative or fraudulent activity.

Q2. The Division understands that equity market makers rely on short selling to facilitate customer buy orders and to ensure that they can maintain two-sided markets without carrying large risky positions. The Division also understands that option market makers frequently sell short to hedge positions taken in the course of market making activities. Why else might market makers sell short? How much of all short selling is accounted for by bona fide market making? Do market makers sell short for purposes other than bona fide market making? Are there ways in which short sales by market makers and other market participants performing similar roles or functions (but that are not subject to some or all of the requirements applicable to market makers) could be viewed as problematic?

The function of a market maker is to provide liquidity for buyers and sellers. As the question acknowledges, market makers must sell short to meet buying demand and hedge risks.[48] Market makers can short for other purposes, such as to engage in convertible arbitrage. However, such transactions are not related to their market-making functions.

The definition of a "market maker" under the Exchange Act does not require any particular registration status, but speaks in terms of the entity's activities.[49] Exchange-based designated market makers (or "specialists" as they were once known) are recognized as market makers because they are obligated by exchange rules to maintain firm bids and offers at publicly quoted prices, allowing investors to enter and exit positions in a reasonably prompt fashion.[50] However, exchange market makers are not the only sources

[48] To allow market makers to fulfill these functions, Commission rules include various exemptions, exceptions or other special provisions that accommodate short sale transactions by market makers. For example, short sale orders by market makers are exempted from the "circuit breaker uptick" rule for short sales to offset customer odd lot orders, or to liquidate an odd-lot position that changes the market maker's position by no more than a unit of trading. 17 C.F.R. § 242.201(d)(2). Commission rules also except market makers from Regulation SHO's locate requirement. 17 C.F.R. § 242.203.

[49] Exchange Act Section 3(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.").

[50] *Overview: NYSE and NYSE Amex Equities Memberships, available at* http://www.nyse.com/equities/nyseequities/1167954368183.html; John Downes and Elliot Goodman, DICTIONARY OF FINANCE AND INVESTMENT TERMS at 412 (Barron's Educational Services, Inc., 7th Ed. 2006). *See also* European Commission Staff Working Document, *Impact Assessment on the Proposal for a Regulation of the European Parliament and of the Council, on Short Selling and Certain Aspects of Credit*

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of liquidity. Other entities, such as block positioners and broker-dealers operating electronic communications networks, also provide liquidity and enhance competition. Similarly, certain highly-automated algorithmic trading firms provide substantial amounts of market liquidity.[51] It has been estimated that more than 50% of daily volume comes from high-frequency traders who have been described as "de facto market makers."[52] Of course, these other liquidity providers do not have the same obligations as exchange-based designated market makers.

In 2008, the Commission provided guidance as to what constitutes "bona fide market making" for purposes of the market maker exception to Regulation SHO's locate requirement. The Commission stated that a market maker engaged in bona fide market making is a "a broker-dealer that deals on a regular basis with other broker-dealers, actively buying and selling the subject security as well as regularly and continuously placing quotations in a quotation medium on both the bid and ask side of the market."[53] Although whether a particular entity is a bona fide market maker depends on the facts and circumstances, the Commission provided examples of bona fide market making activities,[54] and examples of activities that would generally not qualify as bona-fide market making.[55]

Footnote continued from previous page
Default Swaps, SEC(2010) 1055 (Sep. 15, 2010), at 52, *available at* http://ec.europa.eu/internal_market/securities/docs/short_selling/20100915_impact_assessment_en.pdf.

[51] *See* Rel. No. 34-61358, *Concept Release on Equity Market Structure*, 75 Fed. Reg. 3594, 3599, Jan. 21, 2010, *available at* http://sec.gov/rules/concept/2010/34-61358fr.pdf.

[52] *See Speech by Chairman Mary L. Schapiro, Evolving to Meet the Needs of Investors*, at the Practising Law Institute's SEC Speaks in 2011 Program (Feb. 4, 2011), *available at* http://www.sec.gov/news/speech/2011/spch020411mls.htm (noting that in the aftermath of the "flash crash," the Commission is "examining trading or other obligations that might be required of today's de facto market makers: the high-frequency traders which account for over 50 percent of daily trading volume and supply much of the market's liquidity."); *Remarks of Chairman Mary Schapiro before the Investment Company Institute's General Membership Meeting* (May 6, 2011), *available at* http://www.sec.gov/news/speech/2011/spch050611mls.htm (stating that the SEC must consider whether high-frequency traders, who "often derive significant benefit from their role as de facto market makers," should "also have the obligations of market makers as well as other responsibilities with respect to the impact of their technology and trading strategies on the markets[.]").

[53] *See* Rel. No. 34-58775, *Amendments to Regulation SHO*, 73 Fed. Reg. 61690, 61698 (Oct. 17, 2008), *available at* http://www.sec.gov/rules/final/2008/34-58775fr.pdf. In the Release, the Commission reiterated and expanded upon guidance provided in Rel. No. 34-50103, *Short Sales* (July 28, 2004), 69 Fed. Reg. 48008 (Aug. 6, 2004) ("2004 Regulation SHO Adopting Release"), *available at* http://www.sec.gov/rules/final/34-50103.pdf.

[54] The Commission's guidance states that factors indicating an entity is engaged in bona fide market making include: (1) whether it assumes economic or market risk with respect to the securities; (2) a pattern of trading that includes both purchases and sales in roughly comparable amounts to provide liquidity to customers or other broker-dealers (which may include selling short into a declining market); and (3) continuous quotations
Footnote continued on next page

Regardless of how the Commission defines "market maker," however, or the reasons why a market maker or any other trader engages in short selling, there is no reason to exempt market makers from any short sale reporting requirements that apply to others. The rationale for exempting market makers from certain requirements, such as the locate requirement, so that they are not hindered in performing their liquidity function does not apply here. Indeed, if market makers were exempt, one would not get a clear picture of overall activity.

> **Q3. The Commission requests comment on the ways and the extent to which, if any, commenters believe that short selling has been associated with abusive market practices, such as "bear raids" where an equity security is sold short in an effort to drive down the security's price by creating an imbalance of sell-side interest? In addition, the Commission requests comment on the ways and extent to which, if any, commenters believe trade-based manipulation (i.e., manipulating without a corporate action or spreading false information) using short sales is possible? Would greater transparency of short positions or short sale transactions help to better deter or prevent such abuses, or assist in additional appropriate actions to prevent them? If so, what new disclosures should be required?**

In 2008, the Commission issued numerous subpoenas to brokers, investment managers and others in a wide-ranging and exhaustive investigation to determine whether the complaints of Lehman Brothers CEO Richard Fuld, executives from Morgan Stanley, and others alleging short sellers' attacks against their companies' stocks were true. After the investigation was completed, Chairman Schapiro confirmed to the Financial Crisis Inquiry Commission that there was no evidence of bear raids on Lehman Brothers, Bear Stearns or other financial firms in 2008.[56] No enforcement actions against short sellers alleging this type of activity during the financial crisis were ever brought.

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that are at or near the market on both sides, provided that the quotations are widely available to the public and broker-dealers. *See* Rel. No. 34-58775 (Oct. 17, 2008), 73 Fed. Reg. 61690, 61699 (Oct. 17, 2008).

[55] The Commission's guidance states that bona fide market making activity does not include: (1) activity that is related to speculative selling strategies or investment purposes of the broker-dealer and is disproportionate to the usual market making patterns or practices of the broker-dealer in the security, (2) when a market maker posts continually at or near the best offer, but does not also post at or near the best bid, (3) a pattern of short sales executed away from the market maker's posted quotes, and (4) trading that attempts to "rent" the benefit of the market maker exemption to a client. As an example of how a market maker might attempt to "rent" its market maker benefit to a client, the Commission states that if a market maker sells stock (short) together with a synthetic short position (*e.g.*, a conversion) to a client and the client then sells the stock (long) retaining the synthetic short position, the effect would be as if the market maker had "rented" its exemption to the client. *Id.*

[56] Report of the Financial Crisis Inquiry Commission, at 327, *available at* http://fcic-static.law.stanford.edu/cdn_media/fcic-reports/fcic_final_report_full.pdf.

There is no shortage of complaints against short sellers when stock prices fall. The SEC, FINRA and other government regulators receive many tips, have wide-ranging surveillance and investigative capabilities, and investigate claims of bear raids and alleged short selling abuses thoroughly. Yet, over and over again, the most strident allegations of bear raids seem to come from executives such as Lehman's Richard Fuld and Enron's Ken Lay, who looked for scapegoats to divert attention from the true financial condition of their companies. Indeed, short sellers have identified some of the most notorious frauds and accounting irregularities in modern history, often long before market regulators have taken action or even suspected wrongdoing. Time and time again, the evidence shows that corporate officials at the issuers who are responsible for their problems invariably first attempt to blame short sellers for price declines in their companies' shares. They retaliate against short sellers by suing them in civil actions instigating baseless claims and by enforcement investigations against them. They pressure regulators to silence the short sellers by limiting or banning short selling. In other words, those executives are highly incentivized to demonize their critics lest their failed business models, poor risk management or outright fraud come to light.[57]

For example, for months before Lehman's collapse, its CEO, Richard Fuld, attempted to blame and retaliate against short sellers who questioned Lehman's accounting. The Lehman Bankruptcy Examiner's report states that, beginning in March 2008 and continuing through mid-July of that year, Fuld and other Lehman executives repeatedly called the SEC and the Federal Reserve Bank of New York, blaming short sellers for the declines in the company's stock price.[58] The SEC issued emergency orders

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[57] In a 2010 year-end letter to investors, Baupost Group founder Seth Klarman writes that

> short-selling serves a vitally important function. Markets, of course, fluctuate; driven by human emotion, greed, and fear, they can reach significantly overvalued levels. This is bad, both because it can induce some who cannot afford losses to speculate, and because it can lead to an improper allocation of society's resources. ... In addition, the decline that follows periods of market overvaluation is bad for the broader economy, for confidence, and for rational decision making; it also frequently triggers government intervention in markets, with all of its inevitable distorting effects. Just as value buyers can dampen downside volatility, short-sellers can dampen the upside excesses. ... This makes short-sellers unpopular, as the uninformed masses enjoy high and rising securities prices for the short-term profits they produce, without understanding the societal costs of the future reversal. ... Short-sellers, by going against the long-term tide of economic growth and the short-term swells of public opinion and margins calls, are forced to be crackerjack analysts. Their work product is usually top-notch and needs to be. Short-sellers shouldn't be reviled or banned; most should be celebrated and encouraged. ... Moreover, the short-seller who is fundamentally wrong, who mistakenly sells short an undervalued security, will lose money and, if the pattern continues, will eventually go broke. Short-sellers, like long-only buyers, need to be right more than they are wrong; when they are right, their actions are socially beneficial, not harmful.

Baupost Group 2010 Letter to Investors, quoted at Market Folly (http://www.marketfolly.com/2011/03/seth-klarman-baupost-groups-2010-letter.html).

[58] *Examiner's Report, supra* n. 19, Section III.A.3 at 711-716 and Section III.A.6 at 1493.

in July 2008 placing conditions on short sales in Lehman and a select group of financial stocks. Lehman's stock price continued to decline, however. When Fuld sought an investment in Lehman by Warren Buffett in March 2008, Buffett apparently recognized Fuld's complaints about short sellers as a smokescreen for the company's deeper problems. Buffett declined to invest, and later told the Bankruptcy Examiner that, among other negatives, he viewed Fuld's "blaming short sellers [as] indicative of a failure to admit one's own problems."[59] This case is a classic example of company executives blaming short sellers to deflect attention from their own problems. The short sellers' call on Lehman was vindicated.

As another example, although regulators, accountants, lawyers and rating agencies missed the fraud at Enron entirely, short sellers identified the problems at the company in 2000. Short sellers were concerned by the very issues that would prove to be Enron's undoing: aggressive accounting, poor return on capital, numerous one-time gains, poorly explained special purpose entities, high volumes of insider stock sales, and statements about product lines that could not be reconciled with obvious market reality. Had the market responded to what short sellers were finding, the collapse of Enron may have been less severe. But, like other executives who attempt to shift the blame for their companies' problems, Enron CEO Ken Lay blamed short sellers for his company's falling stock price, which dropped from more than $80 per share in early 2001, to the 30s and 20s and teens throughout the fall of 2001, and to less than a dollar per share just before its bankruptcy. Shortly after the September 11, 2001 terrorist attacks, Lay, in an effort to convince Enron employees who were widely invested in Enron stock not to sell their stock, attempted to explain away the company's falling stock price by saying that the company was being attacked by short sellers "just like America's under attack by terrorism."[60] In fact, short sellers had long before then accurately identified Enron as a house of cards. When the facts came to light, the short sellers were vindicated. In 2006, Lay was convicted of fraud.

Independent fundamental research also prompted short sellers to warn of major management and business model flaws years before Fannie Mae and Freddie Mac were placed into Federal conservatorship or GM or Chrysler required direct taxpayer infusions and special legal protections. Investment managers with short positions warned G8 finance ministers in April 2007 of poor risk management in structured finance which led to the global financial crisis. Other examples of cases where short sellers identified misconduct by issuers include Allied Capital Corporation, which settled SEC charges of accounting and recordkeeping violations in 2007, AremisSoft Corporation, which was sued by the Commission for accounting fraud in 2002, Baldwin United, sued by the SEC in 1985 for accounting fraud, and Boston Chicken, which filed for bankruptcy in 1998 (the bankruptcy trustee sued company insiders, underwriters, and the accountants).

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[59] *Examiner's Report*, *supra* n. 19, Section III.A.3 at 665.

[60] *Lay Blames Enron Failure on Attack of Short Sellers*, N.Y. TIMES, Apr. 27, 2006, *available at* http://www.nytimes.com/2006/04/27/business/worldbusiness/27iht-enron.html.

There is no verifiable evidence of short sale abuses to justify imposing new reporting or marking requirements for short positions or short transactions.

CPIC hopes that in issuing this mandated study, the Commission will in fact clearly articulate the tremendous benefits short sellers provide to the markets and investors, as borne out in numerous studies. Short sellers' "activities logically, and in fact, lead to a more stable market where bubbles (both in aggregate and in relative value) are fought by the short sellers… and not, like done by much of the rest of the investing world, simply ridden until the eventually ugly denouement."[61] These benefits were highlighted by the markets' reactions when regulators imposed constraints on short selling in 2008. Several studies have demonstrated that, without short sellers, market quality suffered at a time when liquidity, price discovery, and trade execution efficiency needed to be at the highest level possible.[62] Imposing short position reporting requirements creates a risk that rather than face short squeezes, legal retaliation and other forms of intimidation, short sellers will limit their activities, depriving markets of the benefits they bring.

> **Q4. Would real time reporting of the short positions of all investors, intermediaries, and market participants be feasible, and if so, in what ways would it be beneficial? What problems would it address? What would be any reasons, in terms of benefits and costs, for treating short sale position reporting differently than long position reporting? Would "real time" reporting be necessary to achieve these benefits, or is "prompt" updating for material changes in the short position (such as Schedule 13D updating requirements) sufficient? If real time reporting would be beneficial, should "real time" be defined as "continuously updated as soon as practicable," or as frequent "snapshots" of short positions throughout the trading day? Should "as soon as practicable" be defined and, if so, how? If frequent short sale position reporting of some kind would be beneficial, how frequently should such reports be made in order to realize those benefits? Would real time data be more or less accurate than data reported on a delay? Please explain why or why not.**

It is not clear what "real time" would mean in the context of position reporting. "Real time" is not defined in the section of the Dodd-Frank Act that requires this study.[63] However, it is defined in the context of swap transactions to mean the reporting of data including price and volume, as soon as technologically practicable after the time of execution of a swap.[64] As the swap amendments reflect, *transactions* are best suited to

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[61] Cifford Asness, Foreword, *in* Frank J. Fabozzi, editor, SHORT SELLING: STRATEGIES, RISKS, AND REWARDS, at xi (John Wiley & Sons, Inc., 2004).

[62] See notes 20 - 21 and accompanying discussion, *supra*.

[63] Dodd-Frank Act, § 417.

[64] Dodd-Frank Act, §§ 727, 763.

"real time" reporting, while a *position* is a status that is acquired and maintained over time. It would be highly inefficient to require constant "real time" updates regarding a short "position," which obviously would fluctuate as an investor completes the transactions meant to achieve a particular strategy.

Virtually every short sale in a security will increase, decrease, create or close a "position," and continuous or "real time" reporting of positions would be burdensome and could be misleading. The question is, what regulatory or other purpose would be served by such a requirement? Moreover, if the purpose of position reporting is to understand a market participant's short exposure to a company, a trader's view with respect to the prospects for a company, or whether a market participant is attempting to manipulate or drive down the price of a company's securities, simply looking at that participant's short position in equity securities presents an incomplete and misleading picture. For example, a market participant can easily gain short exposure to a company through bonds, options or derivatives, none of which would be picked up if short position reporting applied only to certain transactions in equity securities.

As noted above, there is a wealth of available information concerning overall short interest in equity securities and securities lending. There is also daily, semi-monthly, and monthly disclosure of short sale transactions by market centers and FINRA. The marginal additional benefit of adding position reporting to this information, whether "real time" or otherwise, would not justify the costs, particularly where it is not at all clear what problem real time reporting is designed to address.

Moreover, the Commission's own experience and actions with so-called position reporting itself appears to suggest that short sale position reporting yielded limited, if any, benefits. The Commission adopted an emergency order and temporary rule requiring investment managers to report short positions on a non-public, weekly basis from September 2008 to August 2009.[65] Investment managers devoted compliance and other resources to assembling and reporting to the Commission the information required; the Commission received and presumably reviewed and analyzed these reports. According to the Commission, it "made the rule temporary so that it could evaluate whether the benefits

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[65] Rel. No. 34-58591, *Emergency Order Pursuant to Section 12(K)(2) of the Securities Exchange Act of 1934 Taking Temporary Action to Respond to Market Developments* (Sept. 18, 2008), *available at* http://www.sec.gov/rules/other/2008/34-58591.pdf; Rel. No. 34-58591A, *Amendment to Emergency Order Pursuant to Section 12(k)(2) of the Securities Exchange Act of 1934 Taking Temporary Action to Respond to Market Developments* (Sept. 21, 2008), *available at* http://www.sec.gov/rules/other/2008/34-58591a.pdf; Rel. No. 34-58724, *Order Amending and Extending Emergency Order Requiring Institutional Money Managers to Report New Short Sales* (Oct. 2, 2008), *available at* http://www.sec.gov/rules/other/2008/34-58724.pdf; Rel. No. 34-58785, *Interim Final Temporary Rule – Disclosure of Short Sales and Short Positions by Institutional Investment Managers* (Oct. 15, 2008), *available at* http://sec.gov/rules/final/2008/34-58785.pdf.

from the data justified the costs associated with the rule."[66] As a result of the Commission's assessment of the benefits of the position reporting requirement, the Commission chose not to extend the rule, and instead, worked with the SROs to provide daily publication of short sale volume and transaction information, as well as twice-monthly disclosure of fails data.[67] From these facts, we gather that the Commission decided that the benefits from the short position reports filed with it *did not* justify the costs associated with the rule. As the Commission chose not to extend Form SH filing requirements, and has not reported its experience with Form SH otherwise, we gather that it provided no benefits greater than the short sale data now available to the Commission and the public.

If the benefits of non-public reporting to regulators were not sufficient to justify the cost, it is difficult to imagine how public reporting of positions would be different, unless the purpose of public reporting is to intimidate or harm short sellers. Indeed, public reporting of short positions could impose significant costs upon the marketplace.

First, public dissemination of short positions would cause competitive harm to investment managers. Investment managers who employ a fundamental short strategy seek to identify overvalued equity securities. In this regard, they conduct rigorous, costly financial analyses that focus on whether an issuer has an unsustainable or operationally flawed business plan, has materially overstated earnings, or otherwise engaged in fraud. This involves gathering information from many sources, beginning with the issuer's financial statements and other reports filed with the Commission and other regulators. It may also entail assessing an issuer's competitors, affiliates and counterparties to significant transactions. Some managers employ accountants, financial analysts, and research analysts for these purposes. These research practices may have been developed over years of experience and at great expense. As a former chief economist for the Commission has noted, disclosure of short positions would allow some traders to be "free riders," copying the positions of others, and benefiting themselves while reducing the gains that would otherwise accrue to those that actually performed the research.[68] Public disclosure of short positions, even after a substantial lapse of time, would reveal such managers' trading strategies, and ultimately prejudice the investors in the funds they advise, including pension funds, universities and endowments.

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[66] *SEC Takes Steps to Curtail Abusive Short Sales and Increase Market Transparency* (Jul. 27, 2009) *available at* http://www.sec.gov/news/press/2009/2009-172.htm.

[67] *Id.*

[68] *See Cox Seeks Emergency Disclosure Rule; Market, Hedge Funds React With Dismay*, BNA, Inc. Daily Report for Executives, No. 182, Sept. 19, 2008, at A-33 ("Chester S. Spatt, a finance professor at Carnegie Mellon University and a former chief economist for the SEC . . . agreed that the proposed disclosure would allow other short sellers to imitate very quickly the trades of the hedge fund disclosing its short position, resulting in the hedge fund not being able to reap the full benefit of the information it produced.").

Second, public disclosure could compromise the ability of investment managers to engage in portfolio risk management strategies. Many investment managers accumulate short positions gradually over time in order to minimize the market impact of their investments. Indeed, some managers may develop a position over a period of years. Their ability to do so would be adversely affected if other investors can imitate their moves by reviewing periodic disclosure of their activity.

Third, public disclosure of short positions would unfairly expose short sellers to retaliation by companies and the risk of "short squeeze" campaigns where company executives or others seek to create a transient condition in the trading of a listed security in which short positions are subjected to unusual financial pressure for a temporary period of time. A squeeze can result in substantial losses for a financial institution holding a short position and lead to increased volatility.[69]

Fourth, public disclosure would expose short sellers to retaliation as issuers cut off communications with analysts at institutions who report short positions in the issuers' securities. This type of retaliation prejudices institutional investment managers and their clients and, more broadly, the process of price discovery.

Fifth, public disclosure may confuse investors. Short selling in a company's stock can occur for a variety of reasons and not necessarily because the short seller has a negative view of a company's outlook. For example, a financial institution may take a short position to lock in a spread or hedge an investment in convertible bonds by shorting the same company's equity. Traders also buy options and/or futures on stock indices and then short the individual component equities in order to profit from arbitrage opportunities. In these instances, public disclosure of short sale positions may mislead investors, who

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[69] For example, a 2008 squeeze in Volkswagen shares briefly made it the largest company in the world, as measured by market capitalization. *See* Jeffrey Cane, *VW Über Alles,* Oct. 28, 2008, *available at* http://www.portfolio.com/news-markets/top-5/2008/10/28/Volkswagen-Is-the-Biggest-Company ("[S]hares of Volkswagen have spiked, giving it a market value of $370 billion, surpassing that of Exxon Mobil . . . On Sunday, Porsche unexpectedly disclosed that it had raised its stake in Volkswagen to 74.1 percent from 35 percent, through the use of derivatives. . . . The price spike resulted from a squeeze. A number of hedge funds had shorted VW shares, betting that the company, like other automakers, would fall in the market as consumers cut back spending."); Sarah Marsh, *Short sellers make VW the world's priciest firm,* Reuters, Oct. 28, 2008, *available at* http://www.reuters.com/article/ousiv/idUSTRE49R3I920081028.

If there is any doubt that some officers of publicly held companies would squander capital on such manipulation, rather than using it to benefit their firms, one need only look to documents produced in congressional hearings on the financial crisis. In an e-mail to Lehman Brothers' Chief Executive Officer, a senior executive stated "I like the idea of aggressively going into the market and spending [$2 billion of a $5 billion financing] buying back lots of stock and hurting [David] Einhorn bad." *The Causes and Effects of the Lehman Brothers Bankruptcy: Hearing Before the H. Comm. on Oversight & Government Reform,* 110 Congress (Oct. 6, 2008), Statement of Henry Waxman, Chairman, H. Comm. on Oversight and Government Reform, at 3, *available at* http://house.resource.org/110/org.c-span.281618-1.pdf. Mr. Einhorn criticized Lehman and was believed at the time to hold a short position in Lehman stock.

may incorrectly assume that the institution has a negative view of the company whose stock is being shorted.

Sixth, as the Commission has found, disclosure of such data may "give rise to additional, imitative short selling."[70] Indeed, public disclosure of short positions could trigger herding behavior and panicky selling if investors see which institutions have shorted a stock.

Seventh, public disclosure of short positions could shift trading to less transparent markets, such as those for swaps, credit default swaps and other derivative transactions. In order to avoid public disclosure of their positions, institutional investment managers may unwind hedged long and short positions, and choose instead to engage in derivative trades that have the same economic effect as a short sale, but which are less transparent and not well understood.

If the Commission were to protect the confidentiality of individual investors' positions, the likelihood and extent of such adverse consequences could be reduced. Thus, if individual investor reports were provided only to regulatory authorities (and were appropriately protected from public disclosure), the costs of compliance, as described above, while not insignificant, would certainly be less, and would also be easier to predict and quantify. But the Commission's failure to renew its short sale position reporting rules in 2009 speaks volumes about the apparent lack of helpful data they produced. If regulators do not find this type of data useful for oversight and regulatory purposes, the only reason to require public reporting of the data would be to punish or intimidate or otherwise harm short sellers.

> **Q5. Who would be likely to use real time short position data, and how? Would the short sale position data be too voluminous to be used directly by investors? Could such data help to detect more easily, better deter, or better prevent short selling abuses? Would market commentators and others use real time short position data to help the public better understand the U.S. securities markets? Would users of real time short position data be able to derive reasonably clear interpretations of the data in real time, and, to the extent they could not, how would the costs and benefits of any reporting regime be affected? Would real time data on short positions help or hinder long-term investors in making "efficient investments?"**

Studies suggest that too much information can result in lower quality decisions than information filtered for relevance. James Montier, in *Behavioural Investing*, examines the research accumulating in behavioral science and cautions about the adverse consequences

[70] Rel. No. 34-58724, *Order Amending and Extending Emergency Order Requiring Institutional Money Managers to Report New Short Sales* (Oct. 2, 2008), *available at* http://www.sec.gov/rules/other/2008/34-58724.pdf.

of information overload. "Unfortunately, we tend to equate information with knowledge. Sadly, the two are often very different beasts. We also tend to labor under the misapprehension that more information is the same as better information. Experimental evidence suggests that often where information is concerned, less is more!"[71]

As discussed earlier, investors already have an enormous amount of short sale data available. Here, releasing short position information would cause confusion in the marketplace. This is due, in part, to the complications inherent in defining what a "position" is. The type of data with the most utility would be gross aggregate short sale transactions by security, on a current (e.g., daily) basis. But if a "position" is the aggregate number of a person's short sales in equity securities, then reported data may only partially reflect the person's investment strategy. On the other hand, if a "position" is a person's "net" holding, it may come closer to a reflection of that person's market activity at a point in time, but will be extremely difficult to provide in real time if all the transaction components of a position have not been fully accomplished simultaneously. To illustrate, a person may sell shares of a company short, but may also take long positions in the company's convertible securities or other financial instruments as long-term holdings. These issues are further complicated if an investor manages several funds (which may have conflicting strategies) and must net out the firm's complete holdings and transactions.

Further, short positions often form components of overall market-neutral strategies, hedging or arbitrage situations. In convertible bond arbitrage, a trader's short sales of equity securities are coupled with purchases of convertible bonds. Executors of estates also sell securities short in order to "freeze" the value of a portfolio before liquidation. Market makers' short sales, as noted above, can be significant, but are associated closely with long purchases. Reporting short positions on the equity side of such transactions would present an incomplete picture to the markets.

Thus, short sale *position* reporting – especially *real time* reporting – would lead to a flood of inchoate data that practically invites misinterpretation to the detriment of the market and particularly retail investors. Releases of short positions could cause widespread investor confusion and fuel volatility. Investors may react to news of a short position in given stock with a rush of long sales, or copycat short sales, accelerating price declines. Other traders may attempt to launch short squeezes, or try to front run covering sales with purchase orders, resulting in more pronounced "dead cat bounces."

In any event, until the Commission clearly defines the type, frequency, and scale of "short abuses" it seeks to deter or detect through short position reporting, it is difficult to reach any conclusions as to whether real-time position data would "help to detect more easily, better deter, or better prevent" them. The markets already operate automated surveillance systems that use algorithms and other detection methodologies to spot

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[71] James Montier, *Behavioural Investing,* at 133 (John Wiley & Sons, Ltd., 2007).

abnormalities in trading activity. A reasonable question to consider is how any new data reporting would enhance existing market surveillance systems.

> **Q6. How would real time data on short positions affect the behavior of short sellers and other investors? Would it affect abusive short selling, in particular? To what extent, if any, would such data deter non-abusive short selling? For example, would such data reveal the trading strategies of non-abusive short sellers? Could the availability of such data create new opportunities for unfair or otherwise abusive market practices, such as bear raids or short squeezes? Could real time data on short positions lead to copycat trading? How would real time data on short positions affect investor confidence?**

Public reporting on positions would profoundly affect the behavior of short sellers and other investors in a number of ways, no matter whether reports are delayed or in real time. As described in more detail in our answer to question 4, above, it would inevitably reveal confidential and proprietary trading strategies that investment managers have developed, at significant cost. It could also compromise the ability of investment managers to engage in portfolio risk management strategies. It would unfairly expose short sellers to retaliation such as the instigation of civil litigation and to short squeeze campaigns. It could result in issuers cutting off communications with analysts at institutions who report short positions in the issuer's securities, thereby limiting price discovery. It could confuse investors. It may give rise to additional, imitative short selling. And, it could shift trading to less transparent markets, where traders can gain short exposure without reporting requirements.

Data as to the impact of enhanced disclosure requirements can be found in a 2010 study released by Oliver Wyman Financial Services and commissioned by the Managed Funds Association. This study examined the effects of manager-level public short-selling disclosure requirements on equity markets in the US and Europe.[72] It concluded that public short-selling disclosure requirements decrease short sellers' participation in equity markets by approximately 20-25%.[73] While some might welcome that news as evidence of being able to protect corporate interests from criticism and preventing price declines, the study's conclusions were quite the opposite. The study found that "as short-selling liquidity decreases, there are material impacts to the markets for the affected securities" including lower trading volumes, wider bid-ask spreads, less efficient price discovery, and higher intraday volatility. The study concluded that markets with public short selling

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[72] *The Effects of Public Short-Selling Disclosure Regimes on Equities Markets, available at* http://www.oliverwyman.com/ow/pdf_files/OW_EN_FS_PUBL_2010_Short_Selling.pdf.

[73] *Id.* at 5.

disclosure requirements "become more expensive and difficult venues for all investors to execute both purchases and sales of securities."[74]

In February 2011, Oliver Wyman updated the study after parts of the E.U. adopted measures to require disclosure of individual short positions above certain thresholds.[75] The update found that fund managers had "seen liquidity decrease as a result of disclosure proposals and [had] seen a consequent widening in bid-ask spreads."[76] There was a "pronounced fear of short squeezes in connection with certain strategies, and most participants noted that access to working with corporate management had decreased."[77] Fund managers also expressed concern that public disclosure of individual short positions would result in unsophisticated investors mimicking trades in the market without a full understanding of the strategy.[78] The study recommended that a better approach would be to adopt the model of the U.S. and Hong Kong, where there is private disclosure to regulators and aggregated anonymous public disclosure of market-wide data such as short interest.[79]

Q7. How would real time data on short positions affect liquidity, volatility, price efficiency, competition, and capital formation? Would real time short position reporting affect equity-related securities markets, such as option or other derivative markets, convertible bond or other debt markets? If so, in what ways?

Real time or other reporting obligations could create unintended and unneeded distortions, add excessively burdensome regulatory compliance obligations, tilt competitive advantages to certain market participants, and reduce short selling activity. This would reduce liquidity, increase volatility, and decrease price efficiency, competition, and ultimately capital formation. If short activity declines, so too will liquidity, given that short transactions provide liquidity, as numerous studies have shown. For every short sale, there is a purchase to close out the position. We can expect this diminution of liquidity in all markets where financial instruments are traded as part of strategies that include short transactions to manage risks and enhance portfolio returns. Please refer to our answers to Questions 4 and 6, above, for additional details.

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74 *Id.*

75 Oliver Wyman, Inc., *The Effects of Short Selling Public Disclosure of Individual Positions on Equity Markets* (Feb. 2011), *available at* http://www.oliverwyman.com/ow/pdf_files/OW_EN_FS_Publ_2011_Short_Selling_Public_Disclosure_Equity_Markets.pdf. The 2011 study was conducted at the request of the Alternative Investment Management Association and sponsored by Deutsche Bank.

76 *Id.* at 6.

77 *Id.*

78 *Id.* at 7.

79 *Id.* at 9, 44.

Q.8. How should "position" be defined to help ensure any short sale position reports would be useful in detecting and deterring abusive short sale practices? Should "position" be defined differently to accomplish another purpose? If so, how, and what purpose would such a definition help accomplish? ... For maximum utility, should short positions be reported gross, or net of long positions, or in both ways? Should short positions include derivatives and index components? Should short positions be the net economic exposure to a stock across all instruments? Should short positions be defined as in former Rule 10a3-T, in which "the Form SH short position is not net of long position?"

As we have discussed earlier, we believe the data that is most useful, and not subject to substantial uncertainty, is data on aggregate gross short sale transactions in a security on a current (e.g., daily) basis. This is the model adopted by the Hong Kong securities regulator governing trading on its exchanges. Indeed, the questions posed in the release reflect the challenge of defining "position" in any meaningful way. It could be defined simply as the aggregate total of short transactions by a particular trader or fund manager per security, but this would not reflect the counter long positions taken using such financial instruments as indices, bonds, derivatives, and/or exchange-traded funds. Other measures might focus on the scope of the calculation: *i.e.*, whether it would encompass positions across a family of funds, or units of a financial firm. More complexity is added to the calculation of a position, particularly when reporting thresholds are involved, by the change in market value of the various components that constitute the position.

If the purpose of position reporting requirements is to give regulators an enforcement tool, then its scope must be limited to capturing data that would detect and deter specifically identified abuses. Indeed, reporting of information that would otherwise be proprietary or confidential should not be required in the name of "greater transparency," unless it can be demonstrated how transparency would allow detection or prevention of misconduct.

The Commission and commenters agree that short selling provides numerous benefits to the securities markets. Short sellers can detect fraud, foster pricing efficiency, help resist the formation of bubbles, and provide liquidity. Short selling is also an essential component of many arbitrage and hedging strategies.[80] In order to preserve those benefits,

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[80] *See generally* Proposed Rule, *Amendments to Regulation SHO*, Release No. 34-59748 (Apr. 10, 2009), 74 Fed. Reg. 18042 (Apr. 20, 2009), *available at* http://sec.gov/rules/proposed/2009/34-59748fr.pdf; Matthew Clifton and Mark Snape, *The Effect of Short-selling Restrictions on Liquidity: Evidence from the London Stock Exchange*, University of Sydney (Dec. 19, 2008), *available at* http://www.londonstockexchange.com/about-the-exchange/regulatory/short-selling-restriction-market-quality-december-2008.pdf; Saffi, Pedro A. C. Saffi and Kari Sigurdsson, *Price Efficiency and Short Selling* (Aug. 30), 2010), AFA 2008 New Orleans Meetings Paper; IESE Business School Working Paper No. 748, *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=949027; Ekkehart Boehmer, Charles M. Jones, and Xiaoyan Zhang, *Which Shorts are Informed?*, Journal of Finance (Feb. 4, 2007), *available at*

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efforts to address any potential abuses attributed to short sales should be narrowly tailored to achieve identified goals. For example, the Commission's experience with Regulation SHO has demonstrated that naked short selling is best addressed by establishing and enforcing delivery obligations.

Moreover, we note the Commission's longstanding concerns with the ability of market participants to use financial instruments such as derivatives to obtain economic exposures mirroring those available in the regulated equity markets. Failure to account for these positions in a comprehensive manner for all market participants in any type of position reporting regime would create a false and incomplete picture of market activities.

We again observe that the Commission gathered considerable data concerning short positions during its year-long experience with former Rule 10a3-T. Did those reporting requirements, which imposed costs on investment managers, produce any useful data whatsoever? If "position" had been defined differently, would it have produced information of greater utility to the Commission? These are questions the Commission should answer, based upon the data it received and, presumably, analyzed.

Q. 8 (cont'd). Please describe the feasibility of any incremental changes to the existing short sale reporting systems that would be necessary to report short sale "positions."

We suppose the Commission could simply resurrect its reporting forms under Rule 10a3-T. In its adopting release for Rule 10a-3T, the Commission estimated the compliance burden for completing a single Form SH at 20 hours.[81] If the Commission determines that reporting should encompass positions in instruments other than stock, this compliance and reporting burden would increase substantially. Moreover, any "real time" reporting requirement would impose significantly more costs.

Footnote continued from previous page
http://papers.ssrn.com/sol3/papers.cfm?abstract_id=855044; Ferhat Akbas, Ekkehart Boehmer, Bilal Erturk, and Sorin M. Sorescu, *Why Do Short Interest Levels Predict Stock Returns?* (Mar. 10, 2008), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1104850; Hazem Daouk and Anchada Charoenrook, *A Study of Market-Wide Short-Selling Restrictions* (Feb. 2005), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=687562; Jennifer Francis, Mohan Venkatachalam, and Yun Zhang, *Do Short Sellers Convey Information about Changes in Fundamentals or Risk?* (Sept. 29, 2005), *available at* http://ssrn.com/abstract=815668; Owen A. Lamont and Jeremy C. Stein, *Aggregate Short Interest and Market Valuations* (Dec. 2003), Harvard Institute of Economic Research Discussion Paper No. 2027, *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=569876 ; Owen A. Lamont, *Short Sale Constraints and Overpricing* (Winter 2005) , *available at* http://www.nber.org/reporter/winter05/lamont.html.

[81] Rel. No. 34-58785, *Interim Final Temporary Rule -- Disclosure of Short Sales and Short Positions by Institutional Investment Managers* (Oct. 15, 2008), *available at* http://sec.gov/rules/final/2008/34-58785.pdf; *see also* Form SH, at 1.

Q. 8 (cont'd). Would any potential definitions of short positions be infeasible in real time?

"Real time" is not defined in Section 417 of the Act. However, it is defined in the context of swap transactions to mean the reporting of data including price and volume, as soon as technologically practicable after the time of execution of a swap.[82] It would be highly inefficient to require constant "real time" updates to position reports. As the swap amendments reflect, *transactions*, and not *positions*, are suited to "real time" reporting. Therefore, as applied to position reporting, defining "real time" to mean "as soon as technologically practicable" or similarly would not be feasible.

Q9. What would be the benefits and costs of short position reporting if "position" was defined to mean short interest, which would be the aggregate number of shares short in each stock? Would real time public reporting of aggregate short interest be feasible? If so, what problems would it address, and how (and by whom) would this data be used? Should the position reporting to be examined in the Division's study be more comprehensive than the current bi-monthly short interest reporting? For example, "arranged financing" (which would include borrowing from a foreign bank or affiliate to cover short positions) is not currently included in short interest. What would be the impact of including arranged financing in a definition of short position?

At present, short interest is reported twice monthly by SROs based on data derived from broker-dealers.[83] Reporting aggregate short interest in "real time" would not be possible because positions in broker dealer accounts are constantly changing. While CPIC members are not broker-dealers, we believe that broker-dealers can manage gathering data across accounts and reporting it twice each month. However, doing so on a "real time" basis would be exceedingly difficult and costly, if it could be done at all. Even if it were possible to implement, the resulting feed of data would only amount to gibberish as the amount of aggregate short interest would constantly be fluctuating. If the Commission were to pursue some form of public reporting, then dissemination of aggregate short interest (*i.e.*, aggregated gross short sale information by security across all exchanges and over-the-counter transactions, possibly on a daily basis)could increase the depth of market data.

Q10. What would be the feasibility, benefits, and costs of real time short position reporting to regulators only, and not to the public? What would the benefits and costs be if this real time reporting information were to be made

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[82] Dodd-Frank Act, §§ 727, 763.

[83] *Short Interest Reporting Requirements*, FINRA Regulatory Notice 08-13 (March 2008), *available at* http://www.finra.org/Industry/Regulation/Notices/2008/P038193.

public on a delayed basis? What length of delay might best balance any benefits and costs?

We believe we have fully addressed above (see Questions 4, 5 and 7–9), the problems inherent in attempting to report any meaningful short sale position data in "real time." We have no objection to reporting short sale position data to the Commission along the lines of its former Rule 10a3-T or in some other manner providing for confidential, periodic reporting to the Commission. The Commission, however, appears to have found short sale position data of little utility, in light of the fact that it discontinued requiring such reports.

In our answers to Questions 4 and 6, we discussed in detail the significant adverse consequences – to investors and to the markets – of forcing short sellers to publicly disclose their positions.

Q11. Who would be in a position to report short positions in real time? Would broker-dealers be able to accurately report customer short positions in real time? Would anyone else be better suited? Would short sellers themselves be equipped to report their own short positions in real time? Would anyone but the short seller be in a position to report the short seller's short position, whether or not the short position was defined as the short seller's economic position including derivatives? What would be the feasibility of adapting the technology infrastructure that supports existing reporting requirements to support real time short position reporting?

We believe the most meaningful short sale information that should be subject to public reporting is aggregate gross short sale transactions per security on a current (e.g., daily) basis. The exchanges are in the best position to provide this data to the public.

We have described above the problems inherent in attempting to report any meaningful short sale position data in "real time" (see answers to Questions 4, 5 and 7–9 above). We believe individual traders, managers and institutions are in a position to provide to the Commission periodic data on their short "positions" (however defined) on some confidential, periodic basis.

However, not all investment managers are in a position to prepare and submit reports in "real time," especially via those systems that are generally used for public dissemination of information. Thus, many advisers to private investment companies are not equipped with the access to trade reporting systems that allow broker-dealers to report transactions on an immediate basis, and are not as familiar with their use. If investment managers were required to report and update positions on a "real time" basis, they would have to invest substantially in new technologies, purchase linkages to reporting systems and engage in extensive training.

While we would not object to a requirement for periodic short sale reports to the Commission, we point to the Commission's own decision to terminate its short position reporting requirements under Rule 10a3-T as evidence of the apparent lack of utility of this information.

Importantly, if the goal of short position reporting is detection and deterrence of manipulation, then use of the short sale transaction data that is now made available by market centers and SROs would be a more efficient methodology than periodic reporting to regulators. Moreover, because regulators are able to immediately access records of investment managers and broker-dealers, there is little or no need for reporting to regulators in "real time." Thus, the most efficient method to use short position data to detect and deter abuses would be through the use of transaction data now made publicly available by market centers and SROs.

> **Q12. Who would be in a position to collect and disseminate short positions in real time? Would it be feasible for listing exchanges to collect and disseminate this information? Would a consolidator be better suited to collect this information? What would be the feasibility of adapting the technology infrastructure supporting existing reporting requirements to support real time short position collection and dissemination? Would short position data developed from existing systems be less meaningful than data from a new system designed for this purpose? Why or why not?**

As noted earlier in this letter, individual short positions should not be publicly disseminated. The only entity that should collect individual short position data, if at all, is the Commission, and individual data should not be disseminated to the public.[84] We also address, above, the substantial problems inherent in reporting positions on a real time basis and the lack of utility of such information in any event. Moreover, we stress that as of yet, the Commission has not confirmed that there are any benefits to requiring real time short position reporting that cannot be achieved by other means. It therefore seems that consideration of requiring market participants to create an entirely new (and expensive) reporting system is premature at this time.

If, on the other hand, the Commission believes that aggregate data, such as daily gross short volume, should be collected and made publicly available, then the entities best positioned to collect and disseminate such information are exchanges and market centers. The exchanges (and FINRA) presently collect similar data regarding short interest from

[84] In this regard, we note that the Dodd-Frank Act amends Section 204(b) of the Advisers Act, effective July 21, 2011, to provide significant protections for confidential, proprietary information that relates to private investment funds and their advisers. The statute defines "proprietary information" to include sensitive, non-public information regarding the investment or trading strategies of the investment adviser, analytical or research methodologies, trading data, computer hardware or software containing intellectual property, and any additional information that the Commission determines to be proprietary.

broker-dealers. Exchanges and other market centers are also the first to observe and record the execution of a transaction. Broker-dealers and other market participants learn of the completion of their transactions only after execution (even if only shortly thereafter). Moreover, market centers are capable of collecting all of the information that would be required, and already possess most, if not all, of the necessary technology for this function.

Q13. What would be the direct, quantifiable costs of short position reporting for those compiling, reporting, collecting, or disseminating the data? Please differentiate implementation costs from ongoing costs and include opportunity costs. How feasible would it be for brokers, exchanges, and others to create or modify a reporting and dissemination system? What would be the particular technological challenges faced in creating or modifying a reporting and dissemination system? Responses based on the costs of implementing the 2007 modifications to short interest reporting or the 2008 implementation of Form SH are particularly requested.

CPIC believes that broker-dealers and exchanges are in the best position to compile, report, collect, or disseminate data on short selling transactions. As such, these entities are best positioned to provide appropriate responses as to this inquiry.

Q14. How would the establishment of a significant reporting threshold, which would limit short position reporting requirements to holders of significant net short positions, affect costs and the utility of the short position information? If reporting thresholds would be useful, would thresholds at the 5% level used under Section 13(g) of the Exchange Act or the 0.25% level used in former Form SH be appropriate, or would a lower threshold, such as that used in the U.K. model, be preferable? Or would a higher threshold be appropriate? Please explain why or why not. Would thresholds (computed on a net basis) at U.K. levels (or the lower levels being contemplated by the E.U.) capture ordinary course, bona fide market maker positions, or would they tend generally to capture only the positions of investors taking a view as to the stock's future price direction? Would a general exemption from position reporting (or public position reporting) for market makers be appropriate? Why or why not?

As discussed in our answer to Question 2, above, there is no reason to exempt market makers from any short sale requirements that apply to others. The rationale for exempting market makers from requirements such as the locate requirement – so that they are not hindered in performing their liquidity function – does not apply here.

However, with respect to the larger question, since more study is needed to estimate the direct and indirect costs, we encourage the Commission to conduct a survey to gather the empirical data necessary for determining these costs as part of its cost-benefit analysis for assessing the merits of any initiatives to require reporting of short transactions and positions. While E.U. authorities have attempted to estimate some costs involved in short sale disclosures, their estimates are of limited value because of the various differences in systems, application and requirements. Much work is needed by the Commission to develop a methodology, including a determination of assumptions, the relevant data to be collected, the approaches to estimate cost projections, and the modeling to show how costs may shift given different disclosure levels and related market variables (e.g., a rise in interest rates, which could increase share borrowing costs). These cost considerations also must assess the potential opportunity costs.

The immediate, direct costs would include the investor's IT and other charges (e.g., human resources) to ensure compliance with new disclosure obligations, the costs associated with intermediaries' services in handling a short sale transaction for a client, and the costs of the security (e.g., movement in value) involved in a short transaction. If public disclosure is made of a particular investor's position above a certain threshold, market participants could seek to emulate that investor's position or take a contrary position. The result would be higher costs for borrowing the security that the original investor needs to cover their short transaction. Liquidity may drop and spreads may widen, adding to the transaction's costs. The "herd effect" may also result in a kind of short squeeze in which a lack of supply and an excess demand for a traded stock forces the price upward temporarily.

All investment decisions involve opportunity costs, which should be another part of the Commission's considerations. Public disclosure of an investor's short position at a certain threshold (in real time or delayed) may distort pricing dynamics in the market as other market participants respond to the news. A resulting escalation in a security's price may close out an opportunity for that investor to expand their position in that security or others in that sector. These costs depend on many hard-to-quantify considerations – including an investor's behavior. They also assume some level of causality. As difficult as these costs are to fathom, the Commission should note the opportunity costs as investment decision-making is narrowed from disclosures that reveal proprietary trading strategies.

If the Commission determines that some new form of public dissemination of short position data is necessary, then we submit that more frequent dissemination of aggregated short interest is most likely to provide useful information to investors while minimizing unintended distortions of prices. Alternatively, and conditioned on appropriate protections from public disclosure, non-public reporting to the Commission of individual investors' short positions above certain thresholds that would be determined based on logistical and cost considerations could be required. However, as discussed above, it appears that the Commission itself determined such position information is of little utility to it.

As to which threshold would be advisable for determining public dissemination of aggregate and individual short positions, the first requirement for the Commission is to determine its objective in expanding information dissemination into the marketplace. Is this need targeted at retail investors? Companies? Institutional investors? Market regulators? Once this objective is established, the information needs of those the Commission believes to be a priority can be defined with more precision.

The next step would be to determine which thresholds would be appropriate. The lower the threshold, the higher the costs, for obvious reasons. Moreover, the Commission would need to consider costs, logistical constraints, and the unintended consequences of information disclosures should it decide to release individual short positions. One consequence may be the gaming of the thresholds by an investor to send signals to the market that they have increased or decreased a short position on a particular security. There may be opportunity costs for investors, too, if they hold their position below the public reporting threshold to protect their proprietary research and strategy.

A comprehensive review of regulatory proposals related to short selling issued by the Association for Financial Markets in Europe ("AFME"), the International Securities Lending Association ("ISLA") and the International Swaps and Derivatives Association, Inc. ("ISDA") in December 2010 expresses these organizations' strong belief that aggregated and anonymous disclosures provide the best means to meet stated policy objectives without harming investors and issuers. These organizations argue that if public short selling disclosure is nonetheless considered desirable, it "should only occur at thresholds that are much closer to those required for disclosure of long positions."[85]

> **Q15. How should experiences with short sale position reporting regimes in foreign jurisdictions inform the analysis of feasibility, benefits, and costs? How relevant are any analyses of other reporting regimes to the Division's study? The Commission requests information on any relevant studies not cited in this request for comment.**

Several foreign jurisdictions have imposed, and some are considering additional, short sale reporting requirements. They vary substantially in scope and requirements. But the forces driving these requirements seem to be the same as those that drove U.S. regulators to impose various limitations and bans on short selling during the financial crisis and which are pushing regulators to consider still new limitations and reporting requirements going forward. There is a belief by many that short selling drives down the prices of otherwise sound companies – a view that has been disproved over and over again, but that remains widely held. And there is the accurate belief that by forcing short sellers to disclose their positions, they will be less willing to engage in short sale activity at all.

We, therefore, do not believe the Commission should benchmark any contemplated short sale position reporting against the majority of other countries who have adopted or

[85] AFME, ISLA, and ISDA, *Short Selling -- A Comprehensive Review of Regulatory Proposals* (Dec. 2010), at 12, *available at* http://www.isla.co.uk/uploadedFiles/Publications/Short%20Selling%20%20complete%20briefing%20paper.pdf.

are considering adopting short sale position reporting requirements. As numerous studies have confirmed, limitations on short selling reduce liquidity, widen spreads, and reduce overall market quality.

A potentially better model is presented in the approach taken by regulators in Hong Kong. In Hong Kong, there are two daily trading sessions. After each one, reports of the total value of all short sales, market turnover and the percentage of market turnover attributable to short sales are disseminated. Reports of the top stocks shorted by value and as a percentage of turnover are also available. The Hong Kong Securities and Futures Commission ("SFC") is also currently considering a proposal to implement reporting – to regulators only – as to gross short positions above 0.2% of the issued share capital of a company or 30 million Hong Kong dollars, whichever is lower (and not including derivatives or OTC transactions), at the end of the last trading day of each week.[86]

In any event, the negative consequences of inhibiting short selling activity via disclosure regimes are confirmed by experiences in other jurisdictions. For example, a proposal to establish a regime for the disclosure of short positions based on thresholds of investors' short positions in the European Union was advanced before the European Parliament in September, 2010.[87] The studies by Oliver Wyman (referenced above) report that the advancement of the proposal has already caused adverse consequences.[88] Interviews of thirty-five market participants revealed that half were "very concerned" about liquidity being reduced as a direct result of disclosure proposals, with another 36% expressing some concern. The research also found that 69% of respondents were concerned that short squeezes would intensify if the measures were implemented.[89] If

[86] *Consultation on Securities and Futures (Short Position Reporting) Rules* (May 2011), *available at* http://www.sfc.hk/sfcConsultation/EN/sfcConsultFileServlet?name=shtpostrptrules&type=1&docno=1. In this regard, the SFC was appointed to lead efforts by the International Organization of Securities Commission ("IOSCO") to harmonize members' short selling regulations. In order not to undermine IOSCO's efforts in this area, we believe the Commission should evaluate the SFC's approach and endeavor to make sure that its actions remain within those parameters.

[87] European Commission Staff Working Document, *Impact Assessment on the Proposal for a Regulation of the European Parliament and of the Council on Short Selling and Certain Aspects of Credit Default Swaps,* SEC(2010) 1055 (Sep. 15, 2010), at 52, *available at* http://ec.europa.eu/internal_market/securities/docs/short_selling/20100915_impact_assessment_en.pdf.

[88] Oliver Wyman, Inc., *The Effects of Short Selling Public Disclosure of Individual Positions on Equity Markets* (Feb. 2011), *available at* http://www.oliverwyman.com/ow/pdf_files/OW_EN_FS_Publ_2011_Short_Selling_Public_Disclosure_Equity_Markets.pdf; *The Effects of Short-Selling Public Disclosure Regimes on Equities Markets* (2010), *available at* http://www.oliverwyman.com/ow/pdf_files/OW_EN_FS_PUBL_2010_Short_Selling.pdf.

[89] Oliver Wyman, Inc., *The Effects of Short Selling Public Disclosure of Individual Positions on Equity Markets,* at 16 (interview findings on concerns about liquidity drying up) and 21(interview findings on short squeezes) (Feb. 2011), *available at* http://www.oliverwyman.com/ow/pdf_files/OW_EN_FS_Publ_2011_Short_Selling_Public_Disclosure_Equity_Markets.pdf.

market participants know of others' short positions, they will be more likely to acquire a stock knowing that covering the short position will inevitably occur, further raising that stock's price and potentially facilitating a squeeze on liquidity. In total, 75% of respondents said they expected equity capital to move out of Europe, 31% in the short term and 44% in the long term.[90]

> **Q16. What benefits, costs, or unintended consequences would flow from adding ... transaction marks to the Consolidated Tape? Who would use these marks, and how? Would data from the Consolidated Tape be accessible to the market participants who are most interested in short selling information? Would the Consolidated Tape data be too voluminous to be used directly by interested market participants? How would the Consolidated Tape marks affect the behavior of short sellers and other investors? Would Consolidated Tape marks help or hinder long-term investors in making "efficient investments?" Would market commentators and others use Consolidated Tape marks to help the public better understand markets? Could such marks help to better detect, deter, or prevent identified short selling abuses? Alternatively, could such marks themselves present opportunities for alleged unfair or otherwise abusive market practices, such as bear raids or short squeezes? Would real time Consolidated Tape marks lead to copycat trading? How would Consolidated Tape marks affect investor confidence?**
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> **Q17. Please discuss the feasibility, benefits, and costs related to the "short sale," "market maker short," and "buy-to-cover" marks specifically, and the effects of any choices that would be made when defining such terms. Would there be a trade-off between defining the trades that would be subject to these marks for maximum utility and accuracy to investors, and minimizing implementation costs by building on existing definitions and order marking infrastructure? If so, how should the tension between these goals be best resolved? Would there be any other potential issues associated with the accuracy or clarity of Consolidated Tape marks? Would the Consolidated Tape marks present possibilities for misinterpretation of the data that could impact any benefits and costs?**
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> **Q18. How would any additions to Consolidated Tape marks affect liquidity, volatility, price efficiency, competition, and capital formation? To what extent, if any, would such data deter short selling activity not associated with abusive market practices, but that enhances market quality, for example, by revealing trading strategies? What are the consequences of such deterrence? Would any additions to Consolidated Tape marks have consequences (including benefits or costs) for equity-related securities markets, such as options or other**

[90] *Id.* at 23.

derivative markets, convertible bond or other debt markets? If so, please explain. What would the feasibility, benefits, and costs be if this real time reporting information were to be made public on a delayed basis? What length of delay might best balance any benefits and costs?

Q19. What would be the direct, quantifiable costs of adding the additional fields to the Consolidated Tape to support new marks? Please differentiate implementation costs from ongoing costs and include opportunity costs. How feasible would it be for brokers, exchanges, and others to modify order management systems, or other systems, for these marks? What would be the potential technological challenges faced in implementing these marks? Would the Consolidated Tape bear significant implementation or ongoing costs? For example, would capacity requirements be significantly higher? Would vendors and others who receive feeds from the Consolidated Tape bear significant implementation or ongoing costs? Responses based on the costs of implementing Regulation SHO Rule 201, Regulation NMS, and Form SH are particularly requested.

Q20. What would be the benefits and costs (including the direct, quantifiable costs) of conducting a pilot for the Consolidated Tape marking? Would a pilot for Consolidated Tape marking be feasible? Would the direct, quantifiable costs of implementing and maintaining a pilot be any less, or more, than those of implementing and maintaining Consolidated Tape marking on all listed issuers? Would market participants be likely to behave differently during a pilot, for example by hesitating to develop new trading strategies?

Q21. What would be the benefits and costs of the *voluntary* component of the pilot? What types of issuers would likely volunteer to participate in a pilot? How would this self-selection affect the usefulness of any data derived from a pilot? Are there other consequences from a *voluntary* pilot? To maximize the utility of any pilot, should the pilot be designed to limit participation in a way that facilitates comparisons of trading in pilot companies and trading in non-pilot companies? If participation should be limited, how should the Commission determine which volunteers to include or exclude from the pilot?

Q22. How should experiences with transaction marking regimes in foreign jurisdictions inform analysis of the feasibility, benefits, and costs? Are there any analyses of transaction marking regimes that are relevant to the Division's study?

Q23. To what extent would Consolidated Tape marks be a substitute or compliment to real time short position reporting? How would the benefits and costs of any Consolidated Tape marks be impacted if real time position reporting existed and vice versa?

We are not aware of any types of abusive conduct involving short selling that transaction marking would help to address. Certainly, there are more direct, more efficient and faster means to address abuses such as manipulative trading or "naked" shorting. Therefore, it may be that adding marks to trade reports will only increase the amount of "noise" in the market. After all, marks carry a limited amount of information: one could not tell from a mark whether a given short sale is directional or a hedge, for example.

Adding marks to publicly disseminated trade reports also may have significant negative consequences. Specifically, the limited amount of information denoted by a mark could lead to investor confusion. Investors effect short sales for a variety of reasons, not only because they have a bearish view of an issuer. Some investors may sell an equity short as part of convertible arbitrage. The vast majority sell short in order to create a hedge. Estate executors may also sell short in order to freeze the value of a portfolio. Market-makers and block positioners sell short in order to fill buy-side demand. Retail investors may misinterpret a "short" mark as indicating bearish sentiment, when the underlying sale was only a component of an otherwise market-neutral strategy.[91] This may have the unintended effect of encouraging investors to sell when they would otherwise hold, leading to greater volatility and downward pressure on stock prices. Short selling is not well understood by the investing public, as is evidenced by the many common misperceptions that surround it.[92] It is therefore highly likely that some investors will overreact to reports of sales marked as "short." In any event, without information as to derivatives transactions or other transactions to gain short exposure, markings in reports of equity sales could be incomplete and misleading.

It is also possible that, as noted by the NYSE, short marking may "exacerbate short selling" as momentum traders or others seek periods of high short selling activity.[93] Likewise, some traders may perceive "market maker short" marks as indicative of strong buying interest in a stock. These traders may seek to use that information to the market maker's disadvantage, such as by front running the market maker's covering purchase. Algorithmic and other high-frequency trading programs could be programmed to react to such marks in order to do so. Trades such as these may disrupt a market maker's ability to maintain an orderly two-sided market.

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[91] *See* Comment Letter from NYSE Euronext dated October 1, 2010 on the studies required under Section 417 of the Dodd-Frank Act, noting that "much short selling activity may be market making in nature and therefore may not signify a genuine short position." *Available at* http://www.sec.gov/comments/df-title-ix/short-sale-disclosure/shortsaledisclosure-18.pdf.

[92] As noted above, 1991 Report by the House Committee on Government Operations found that "the psychological environment surrounding short selling has led investors to systematically overestimate the manipulative power of short sellers." Short-Selling Activity in the Stock Market: Market Effects and the Need for Regulation (Part 1) (House Report), H.R. Rep. No. 102-414 (1991), *available at* 1991 WL 262146.

[93] *See* Comment Letter from NYSE Euronext dated October 1, 2010 on the studies required under Section 417 of the Dodd-Frank Act, at 4, *available at* http://www.sec.gov/comments/df-title-ix/short-sale-disclosure/shortsaledisclosure-18.pdf.

Other regulatory authorities have determined that including short sale marks in public transaction reports would not be appropriate.[94] For example, the Investment Industry Regulatory Organization of Canada (IIROC), believes that "'short sale' and 'short-marking exempt' flags should not be included in the public order display." IIROC has noted that "[d]aily information for a particular security can be distorted by the effects of a small number of trades, particularly with securities of limited liquidity or high volatility."[95] In 2003, the United Kingdom Financial Services Authority ("FSA") considered and rejected a marking and reporting regime for short sales in equity markets because the benefits would not justify the costs.[96] While these and certain other regulatory authorities in other jurisdictions have trade marking requirements, they do not appear to require their public dissemination.[97]

In addition, the possibility that other market participants might seek to use marks to discern the identities or strategies of parties whose transactions are publicly reported cannot be discounted. If such were to occur, then the negative consequences of public disclosure of short positions (see above, pp. 20-22) would be incurred. This could cause short sellers to move transactions to other, less well understood markets and lead to reduced liquidity and wider bid-ask spreads.

However, we do not object to the Commission proceeding with a pilot program for marking short sale transactions.[98] Although the exchanges and broker-dealer community

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[94] IIROC Notice, *Provisions Respecting Regulation of Short Sales and Failed Trades,* 11-0075, at 50, Feb. 25, 2011, *available at* http://docs.iiroc.ca/DisplayDocument.aspx?DocumentID=146045805l6B48F88A0BCFA629781242&Language=en.

[95] IIROC also takes the position that, as is the practice in the United States, regulators should have access to such signifiers. *Id.*

[96] FSA, *Short Selling: Feedback on DP 17* (Apr. 2003) at 4, 16, *available at* http://www.fsa.gov.uk/pubs/discussion/fs17.pdf.

[97] It appears that no regulators require public dissemination of such markings on trade reports (the examples cited in footnote 44 of the Release relate to trade marking requirements in the cited jurisdictions, but do not appear to require public dissemination of marks in trade reports). A comprehensive review of regulatory proposals related to short selling issued by AFME, ISLA, and ISDA in December 2010 notes that a requirement to mark short orders on trading venues would result in disproportionate implementation costs. The joint review also states that the information provided to the market would be confusing and not useful. AFME, ISLA, and ISDA, *Short Selling -- A Comprehensive Review of Regulatory Proposals* (Dec. 2010), at 6, *available at* http://www.isla.co.uk/uploadedFiles/Publications/Short%20Selling%20%20complete%20briefing%20paper.pdf.

[98] As the Release notes, it is possible that traders could adjust their actions during a pilot program. A sort of "Heisenberg's Uncertainty Principle," where the observed participants in a trading scenario react to the observation, seems to be an unavoidable possibility in any pilot program. Nonetheless, such programs can produce valuable evidence and insights. Although a difficult task, we believe that in a well-designed study, the Commission's staff and other experts would be able to isolate the effects of attempted evasion and determine how markets would behave without it. To that end, the ability of some issuers to "opt-in" to the

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are best situated to discuss the costs of implementing a marking program, we believe the necessary changes to CTA systems could be significant.[99] In an October 1, 2010 comment letter on the studies required under Section 417 of the Dodd-Frank Act, NYSE Euronext states that real time reporting of short selling activity would be feasible if the requirements covered simply long and short sales, but adding the categories of "market maker short," "buy to cover," and "long," would require adjustments to the Securities Information Processor, and necessitate changes to the entry of information by the sending firm.[100] The letter states that the costs of integrating the different reporting systems in use across market centers and OTC markets would also be significant.[101]

* * *

As the Commission and numerous reports and studies have found time and again, short selling brings significant benefits to the markets and to investors. As the Commission gathers and reviews comments regarding this study, we urge that it employ a deliberate approach toward consideration of any further regulation of short selling. The Commission should not create new short sale disclosure or reporting requirements when it has not identified any specific market abuses attributable to short selling that are not capable of being addressed under current regulations. The Commission must base any actions in this area on empirical evidence.

Footnote continued from previous page
study may result in distortions. However, if such issuers were included in a sample of issuers that included companies that did not opt in, these distortions could potentially be identified and quantified.

[99] In 2002-2003 the FSA issued and considered a Discussion Paper in which it sought comments on a short sale marking regime. It concluded that the costs of such a program would be "significant" and would not be justified. FSA. *Short Selling: Feedback on DP 17* (Apr. 2003) at 4, 16, *available at* http://www.fsa.gov.uk/pubs/discussion/fs17.pdf.

[100] *See* Comment Letter from NYSE Euronext dated October 1, 2010 on the studies required under Section 417 of the Dodd-Frank Act, *available at* http://www.sec.gov/comments/df-title-ix/short-sale-disclosure/shortsaledisclosure-18.pdf.

[101] *See id.*

We appreciate this opportunity to provide our comments, and look forward to working with the Commission as it continues with its important work.

Sincerely,

James S. Chanos
Chairman
Coalition of Private Investment Companies

cc: The Honorable Luis A. Aguilar, Commissioner
The Honorable Kathleen L. Casey, Commissioner
The Honorable Troy A. Paredes, Commissioner
The Honorable Elisse B. Walter, Commissioner
Elizabeth M. Murphy, Secretary
Amy Edwards, Assistant Director, Division of Risk, Strategy and Financial Innovation