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

6 May 2011,

**File Number 4-627**

**Re: Short Selling Comments and Global Market Crisis**
**[Release No. 34-64383; File No. 4-627]**
**Short Sale Reporting Study Required by Dodd-Frank Act Section 417(a)(2)**

Dear Madam,

The SEC has requested the views of the public on short selling. The following observations are made to assist in the SEC's consideration of the matter.

## Current position

Stock markets have crashed since 2007. Banks share prices have collapsed. Credit availability is severely curtailed. Bear Stearns. Lehman. Washington Mutual. Wachovia. AIG. The casualties are large. The conditions still exist for a continuation of the collapse.

Policy responses can make a significant difference. Not every policy response requires significant costs or cash outlays for government or the taxpayer. The SEC can significantly assist improvement in market forces.

If one looks at the collapse in the US banks, there is a large body of evidence that indicates that short-selling exaggerated the collapse in share prices.

## Issues

Is short-selling a legitimate trade? Is it right that you can sell something you do not own?

With short-selling, you do not need capital to make a sale. Therefore, non-capital holders carry a big advantage over those that are forced to have a certain amount of capital. The short-sellers can then beat banks, on a very unbalanced footing. Is this fair to investors? Is it fair to banks? Is it fair for the economy?

Does short-selling encourage financial stability in stock prices? It is difficult to accept that short-selling, that can fluctuate by several millions of shares from one day to the next, promotes stable stock prices.

Does the fact that the SEC is making a limited number of proposals for short-selling rules mean that the SEC is already accepting the position of the short-sellers as being good for stocks or good for someone else?

Who gains from short-selling? Who loses? Is the balance fair? Can it be made significantly fairer? Yes, the SEC can.

Does short selling benefit the market? The supporters of short selling state that it adds liquidity to markets and provides a larger supply of buyers/sellers to the market. This is fine if the proportion of short sales to regular sales is steady or is at a tolerable level of sales (say not more than 20%). But when the short sellers see a down market, they can flood the volumes with sales orders and significantly depress the price of a stock. Where the ability to short sell is combined with the need for the target institution's need to raise capital, forced by regulation on foot of BASEL capital adequacy rules, the target institution is very exposed to being not only wounded but being totally destroyed in a very short period of time.

Both Wachovia and Washington Mutual were classic examples of this.

Then there is the spill-over ability of the short-sellers to then target the acquiring institutions (e.g. Bank of America, Citi, Wells Fargo, JPM). So the controls on prevention of destruction of wealth are absent to the severe disadvantage of long term holders of shares, pension funds, and other bodies receiving income from taxation on dividends.

Further, in testimony concerning the crash, executives from Goldman Sachs [GS] appeared to indicate that GS seemed to have placed very substantial short selling orders. Some believe the amounts estimated to be equivalent to its total portfolio in short selling in the year of the crash. This seems to not only have been a gigantic gamble, which paid off for GS, but which almost brought the whole financial system in the USA to the ground.

**Complications**

To have short-selling co-existing with no restrictions in the context of legally required limits on capital for banks obviously brings the capacity for large-scale financial instability in a down-market. The short-sellers can take the wealth of the nation, and destroy long-term investors interests, which now obviously is also to the disadvantage of the state.

The huge costs of the fall-out from short sellers are not counter-balanced adequately merely from an up-tick rule. The measures required to counter-balance the adverse effects of short-selling need much more significant re-balancing.

Until the interests of long term investors, as well as those of protecting the nation's wealth, are balanced more fairly, those who have no interest in any institutions future, can work to destroy that institution, using short-selling as an aggressive, undefendable, means.

The defences to extra heavy volumes of short-selling are not strong enough to make the game a fair one. This is where policy makers can play a more significant role. Whose interests should the SEC safeguard here? Short-sellers - who are not likely to have contributed to the growth of the institution or the economy? Investors – who may have continuously supported the building of institutions, and who partly finance the continuity of the enterprise? Employees – who have worked to build an enterprise? The taxpayer – who gains tax from the sales, salaries and dividends of those involved in the institution? The nation – who gains from a greater level of wealth? Brokers – who make a twist on volumes of shares sold? A fairer approach to this might weigh a decision in a more appropriate direction by the SEC.

Addressing a few of the questions raised by the SEC: -

## Q1 – HOW AVAILABLE SHOULD SHORT SELLING DATA BE?

If the SEC, economists, investors and advisers do not know what is fundamentally happening in securities markets on a security by security basis, how can it develop cures to resolve financial crash conditions?

It may well be key to monitoring the role of short selling to obtain additional data. This should be widely available, and not just to market makers or regulators alone. The reason wider availability of data should be allowed, is that observers may be better informed as to imperfections and imbalances in the market.

The US regulatory authorities do not appear to have a solid information base in relation to the scale and extent of short selling. Taking a bank like Wachovia, the daily volumes ranged between 50million shares a day and increased to around 140 million a day during the crash. At $50 per share, this can be huge money, especially relative to market capitalisations, and more so in relation to shareholders funds, or the capital base of a bank. It is also huge exposure for short sellers, and huge pressure on regulators as well as the institutions, as daily values of shares can quickly become billions within a few weeks or so.

Further, short sellers tend to crystallise a capital gain in a short sale. If they do not own a share, they make a short sale order of say 1 million shares at say $50 per share, receiving an income of $50million, with a cost at the outset of nil. This involves a capital gain, or an income of $50million. At the very last, your taxation (or Internal revenue Service) authorities should have an interest in who has carried out the transaction. So, it is important that some tracing of transactions should be available to the government. It is not until that transaction is closed out, from the purchase of shares that the income or capital gain is reduced.

For more informed analysis and solutions, the USA needs considerably more data on short selling. This may entail some costs, but any costs should be borne by short sellers, and the arguments in relation to prevention of collapses, and better financial control, as well as protection of the wealth of a nation, move a position towards favouring better data availability.

Marking transactions "long," "short," or "market maker short," and purchases of their shares marked "buy" or "buy-to-cover," may not be sufficient for better supervision of a nations wealth. More data may help to show the benefits of short selling, as well as determining who the real beneficiaries and sufferers are. Until recently, there has been a presumption that favours short selling. The rationale now needs to be severely questioned. If it is bad to allow my house to be short sold, even though I might facilitate liquidity by allowing it for my neighbourhood, it is seriously doubtful if the nation is better off with short selling to an extent to allow it to continue on an unfettered basis.

## Q2 Do market makers sell short for purposes other than bona fide market making?

It may be worth repeating, in testimony concerning the crash, executives from major market makers like Goldman Sachs [GS] appeared to indicate that major market makers seemed to have placed very substantial short selling orders before and during the crash. My recollection is that one market maker's profit in one year was almost totally from short selling. Some believe that orders for amounts estimated to be equivalent to a market maker's total shareholders funds, and possibly its total portfolio, were placed in short selling on aggregate throughout the year of the crash. This seems to not only have been a gigantic gamble, which paid off for one market maker, but which almost brought the whole financial system in the USA to the ground.

At the moment, could the SEC say whether the largest market makers or other bank positioning may have contributed to the collapse of banking competitors? If not, it is likely the SEC and the public does not have sufficient data. If so, the SEC and public should have access to the information to counter-balance the power of market maker information that is likely to be in the hands of market makers alone.

One of the problems with short selling is that there is no requirement for bona fides on the part of the short seller at all. Investors can short sell just to raise cash. Competitors can short sell to take positions against competitors. Short selling, per se, has no up-front bona fides requirement. This puts short sellers in positions often contrary to long term investors, pension funds and regulators.

Accordingly, short selling needs much closer attention, and much stronger regulation, because it can inflict a huge quantum of damage in a quick period of time.

**Q3 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?**

Do short sellers provide appropriate gains or income information in tax returns? Does short selling favour money laundering? What does short selling add to the wealth of the nation? Traders and market makers like short selling because of higher commissions and volumes. But is short selling good for the citizen?

The scale of short selling in shares appears to be so large, that it is appropriate to question more closely the motives, profits, influences, and fairness of the system. Better accountability would help in shaping appropriate policies for short selling for the future.

A basic objection to someone selling my house without my knowledge or without owning it still applies to short sellers in general.

If short sales were taxed (say payment of the capital gain or income tax, or indeed a transaction tax at the time of order), the legitimate and longer-term supports of a nations business may be more sustainable in the long term.

Lack of accountability and lack of transparency merely assist short sellers to adopt hostile and abusive positions in markets. Market makers may deny this, but the recent crash and senate committee testimonies from major market makers appear to show short selling was one of the factors behind several large financial institutions having to be bailed out.

**Solutions**

So it seems there is a fundamental flaw in stock market practices or regulations, where short-selling can exist in an unrestricted manner.

The field of play for providers of long-term capital for an economy is unfairly tilted in favour of short-sellers.

It seems that permitting shares to be "borrowed", without any title, conveyance, loan agreement, or consent expressly obtained from the owners provides scope for considerable potential damage to an institution, and indeed an economy. The SEC must address this to improve matters for the long term improvement in markets.

New approaches and mechanisms are urgently needed to prevent a recurrence of the bank collapses.

Perhaps brokers have agreements with shareholders that they can "borrow" their shares. So this needs to be considered more by regulators. In the circumstances of the past month or two, it seems there may be a regulatory black hole here. Accordingly, as long as the system is allowed to continue as it currently exists, the system cannot be defended in practice or in fairness. Market making in stock markets allows an exit mechanism that allows for shares to be sold. Brokers say they need to have a supply of stock/shares to make a market. But current broker practice seems to force sellers to sell, regardless of volume, regardless of the valuation, and regardless of the return, and thereby facilitates bear market price crashes of the magnitude we have just witnessed. Brokers will argue against curtailing this because of the liquidity implications in not having shares to sell on-tap. However, somewhat lower levels/volumes of "borrowed" stock availability would have slowed down the crash, and fundamentally may have put a limit to volumes (and also to valuations) for bank shares.

However, in the case of banks, they have been doubly hampered by the capital adequacy needs, which has added to the potential for the crash, and to the impetus of continued short-selling of such shares in particular.

There are non-cash outlay and other policy solutions that need to be considered.

The SEC needs to examine and see what is happening, so that appropriate solutions can be implemented quickly. The system that continues to-day for bank stocks is still flawed, and further crashes can occur. So to continue as it exists to-day, is not the best option.

Some aspects that require further action may include:-

1. The SEC should consider more measures on "borrowed" stocks. Allowing value to be disposed of by "stealth" is intrinsically unfair. There may be evidence of that volumes of "borrowed" shares increase in a falling market – for example, volumes in HBOS shares amounted to over 380 million in mid September 2008 per day compared with a level of around 70 million a day in 3 months previously (also probably higher than usual).

2. Perhaps the returns to the lenders of stocks needs to be taxed more, or banned.

3. Perhaps the SEC should consider forcing a closer matching between buyer and sellers in timing and volume. Or perhaps limitations should be introduced on timing and volume matters.

4. Perhaps excessively high returns within an excessively short period should attract higher tax rates, for example a "super return" tax deducted on all share sales until reclaimed from the Revenue, with allowances later allowed for capital gains tax assessment based on share acquisition cost deductions. Such a "super return" tax should preferably be deducted at the stock exchanges or at national dealer/broker levels.

**Scope for Action**

The scope for action depends on the approach of institutions with a supervisory or governing role in banking and money markets.

In an emergency financial market situation, the SEC can have a significant role to play.

The SEC needs to re-balance instruments in stock markets in favour of long-term interests, and to significantly counter-balance or curtail the scope that short-sellers can impact negatively to inflict catastrophic damage to the US economy.

This note argues for short selling to be considered as a negative factor in a crash, as a negative factor for share valuation, and as a negative factor against which banks have little or no defence from a share capital point of view. Accordingly, moves towards greater transparency, better control, and perhaps taxation should be considered as counter-balancing factors to curtail its scope.

We have provided some further information about bank recovery, bank bonus policies, and capital measures on our web-site at http://www.battle.ie/bis.html.

I truly hope this note helps in considering the role that short selling can have especially when it can potentially contribute damage to the further collapse of the financial system.

Yours sincerely,

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Ruairi O Nuallain
Director