February 2nd, 2011

Vendors Meeting

Dodd-Frank Financial Reform Act
Section 417(a)(2) (Short Sale Reporting)

Submission by:

Data Explorers

SEC. 417. COMMISSION STUDY AND REPORT ON SHORT SELLING.

(2) a study of—

(A) the feasibility, benefits, and costs of requiring reporting publicly, in real time short sale positions of publicly listed securities, or, in the alternative, reporting such short positions in real time only to the Commission and the Financial Industry Regulatory Authority; and

(B) the feasibility, benefits, and costs of conducting a voluntary pilot program in which public companies will agree to have all trades of their shares marked ‘‘short’’, ‘‘market maker short’’, ‘‘buy’’, ‘‘buy-to-cover’’, or ‘‘long’’, and reported in real time through the Consolidated Tape.

Introduction

Data Explorers would like to thank the Commission for the invitation to attend this Vendors roundtable.

We are experts in the field of securities lending and short selling data. Our aim is to provide increased transparency and operational efficiency to the market.

We maintain close contact with regulators around the world, and in the past we have been consulted by bodies such as the SEC, the OCC, the FSA, and the Bank of England. We count the Federal Reserve Bank of New York and the European Central Bank as data clients.

Market participants have voluntarily contributed their global securities lending trade information to us since 2002. We now have the largest and most transparent database of this type in the world. The data represents the majority of the global equity and fixed income loans used to settle covered short sales.

Our database covers lendable inventory of $12 trillion including equity and fixed income securities, of which $1.9 trillion is currently on loan. This represents about 3 million daily transactions from more than 22,000 investment funds. These transactions are consolidated into 200,000 security level data points, with more than 100 data fields covering supply, demand and rates in the securities lending market.

We consolidate individual transaction data and publish this to our customers and the market via News stories, proprietary APIs, data-feeds, websites and third party channels such as Bloomberg, S&P, and Thomson Reuters.

We protect client anonymity and therefore provide the equivalent of consolidated disclosure. This data is published twice daily, using consistent metrics across a broad range of equity and fixed income markets.

We have more than 200 clients around the world. This includes over 90% of both the industry Agent Lenders and large Prime Brokers. We also have a significant and growing presence in Alternative and Traditional investment managers, including most of the largest global hedge funds.

We welcome the SEC's short selling transparency initiative and offer any assistance we can provide in understanding the dynamics of the industry and implications of any policy implemented by the SEC.

Our business has been instrumental in bringing greater transparency to the securities lending market. Our experience indicates that financial transparency in general can lead to increased market size and depth.

We recommend high frequency private disclosure, which places the majority of the cost of compliance on the short seller. We recommend low frequency public disclosure, which minimizes the public cost of collection and reporting but achieves the overall aim of regulating short selling and managing unintended consequences.

Data Explorers responses to the SEC questions:

1. Mechanics and costs, from your point of view, of aggregating and reporting the data

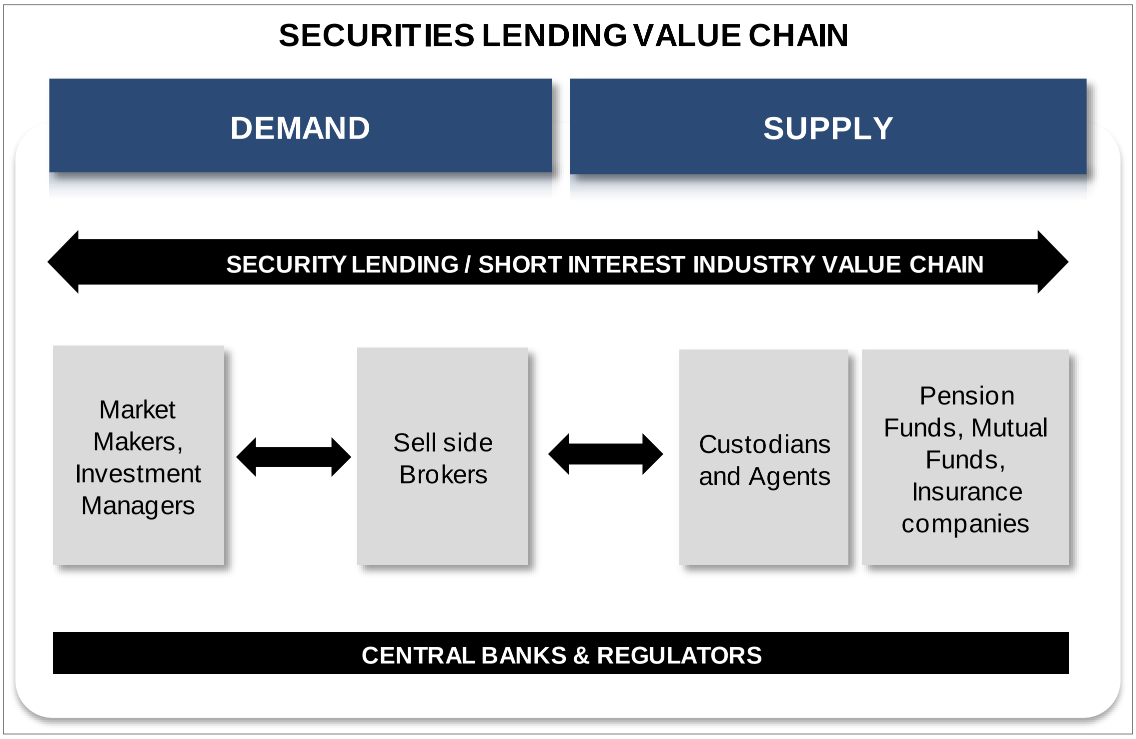
Data Explorers is well positioned to extend its current customer contribution mechanism to aggregating and reporting the data.

1.1. Data Explorers business is the consumption, aggregation and publication of customer contributed data. It regularly grows its contributor base by adding new clients / data contributors to its database and has processes and resources in place to accommodate regular and systematic growth to its contributed database, its systems are scalable and well positioned to grow with the data.

Data Explorers has the capabilities to consume data contributed in a variety of formats. Customers contribute their positions daily to Data Explorers. They do so in a variety of text and Excel formats using extracts from their Books and Records. Most clients follow a set of standard file specifications, although Data Explorers has developed a range of translators to accommodate clients whose systems are inflexible or dispersed.

Data Explorers customer base includes all of the participants in the market (see Exhibit A). Prime Brokers and Investment Managers already contribute data to Data Explorers.

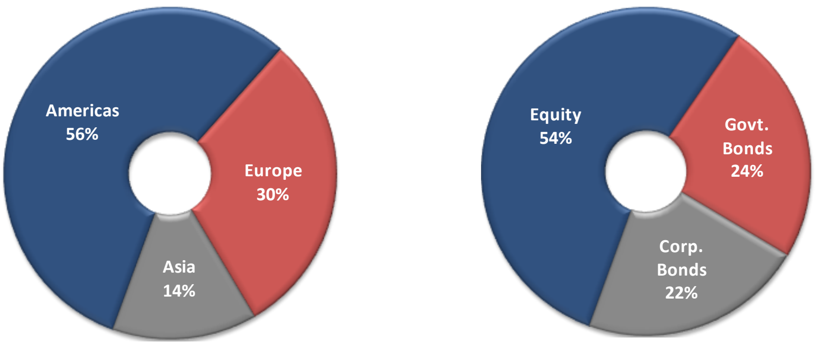
Exhibit A. Data Explorers client base



1.2. Data Explorers database is comparative in size to the proposed data (see Exhibit B):

The Data Explorers database covers 3 million daily transactions from more than 20,000 investment funds globally. These transactions are consolidated into 200,000 security level data points, with more than 100 data fields each, covering supply, demand and rates in the securities lending market. It covers all geographic regions with a history dating from 2002.

Exhibit B. Data Explorers Database statistics



- $12 trillion of lendable inventory
- $1.9 trillion of loan balance
- 22,000 contributing funds
- 20,000 equities

- 200,000 bonds
- 4 years of daily data
- More than 90% of lending activity

This data is collected on a daily basis from over 200 clients globally, including over 90% of the industry Agent Lenders and large Prime Brokers. Data Explorers also has a significant and growing presence in Alternative and Traditional investment managers, including most of the largest global hedge funds.

Exhibit C shows the scale of lending activity in all major asset classes based on the Data Explorers database:

Exhibit C: Global Lendable Inventory and Loans as of January 27th, 2011

	Lendable Value $m	Value on Loan $m
All Securities	12,727,063	1,919,184
All Equities	7,357,526	794,339
All Bonds	5,351,613	1,124,636

Source: Data Explorers

Exhibit D shows the scale of lending activity across global equity markets based on Data Explorers database:

Exhibit D: Equity Lendable Inventory and Loans as of January 27th, 2011

Country	Lendable Value $m	Number of Stocks Value > 0	Loan Value $m	Number of Stocks Value >0
Americas	4,175,388	5,929	409,258	6.897
EMEA	1,893,355	2,947	225,315	3,150
Asia	888,922	4,109	85,260	4,818

Source: Data Explorers

These metrics and analytics are reported through a range of APIs, web applications, data-feeds, third party platforms such as Bloomberg, Thomson Reuters, S&P and Factset, news reports and hard copy reports to clients.

1.3. Data Explorers would implement the aggregation and reporting of the data within its existing infrastructure

We continuously expand the range of asset classes and historical data depth across the universe of securities financing trade information. As such, we would look to ingest, cleanse, publish and store a consolidated tape within our existing development plans and manage costs within our existing infrastructure.

We look forward to evaluating a detailed specification in order to be able to provide accurate cost and development plan details; however below is our initial assessment:

- The incremental costs to Data Explorers would include extended data storage, software development for file ingest, errata production and mapping, addition of new fields to the Data Explorers publishing system. It is not envisaged that these costs would be significant.

- Data Explorers products are built upon our proprietary Securities Lending Platform (SLP). The SLP provides data import, data storage, administration applications and reporting services. Data transfer and import is performed periodically 24/7 to capture source data as soon as it is made available from client systems. This system would be appropriate for capturing this data.

- We have a private network segment for production web services and a second segregated DMZ network segment for "unsecured" FTP services at Rackspace. Our production network currently comprises 10 load balanced web / application servers and 6 database servers in addition to firewall, load balanced switch and gigabit Ethernet switches and associated data communications infrastructure. We currently utilise 2.1 terabytes of monthly outgoing bandwidth with technical performance SLAs of 100% network uptime and 1-hour hardware replacement guarantees. This would provide the infrastructure required for this project.

- Data Explorers operate on a quarterly software development cycle and it is anticipated this project could be delivered within one quarter.

The steps we would take to implement this system are:

Investigation:

- Specification of the consolidated tape file format including update frequency for publication and errata, symbology mapping, error checking for duplicate or malformed fields, field formats, field flags, procedures for refetching files and file transmission protocols.
- Specification of quality checks both automatic and manual for file ingest
- Specification of storage requirements including data security, hot swop live recovery, projected data storage size and archival storage
- Specification of standard mapping protocols for identity extraction
- Preferences for data publication requirements as file feeds, online access, API, Excel data, syndication, etc.
- Quality of Service targets including error reporting, system uptime, system processing turnaround time

Development and testing:

- Ingest file translator including file format, error checking and mapping
- Database design and implementation
- Publishing design and implementation

A more detailed plan can be submitted following evaluation of the detailed specifications for this project.

2. Costs, from your point of view, to modify your systems to accommodate the changes in the consolidated tape

Data Explorers would be similarly positioned to accommodate the changes in the consolidated tape. We would implement this as a standard additional data ingest following the process described in 1.3. above. We can provide considerably greater detail on this point if required and would welcome a more detailed discussion to explore ways in which our existing infrastructure could be leveraged for these purposes.

3. Value to your clients if short positions were to be made public in "real time"

3.1. Overview of Data Explorers Client Base

Data Explorers clients include pension funds, mutual funds, insurance companies, custodians, agent lenders, prime brokers, hedge funds, sellside research companies, central banks and regulators as described in Exhibit A above. They span all geographies.

These clients have a number of functions:

- As agent or principal, they are engaged in lending long positions to short sellers to cover their trade settlement in return for a fee.
- As agent or principal, they are engaged in borrowing stocks and /or short selling as part of their investment activities.
- As investment managers or advisers, they use long and short fund flow at the security or sector level in their portfolio construction decisions.

3.2. Potential benefits of the short positions being made public in 'real time' to Data Explorers clients

3.2.1. Potentially increasing overall transparency of the market

Public disclosure in 'real time' would provide market participants with more information generally. This reinforces investor confidence and will be particularly reassuring following some of the negative publicity that has surrounded short selling in the past. On the other hand, disclosures may be misinterpreted by asset managers and lead to distortions in the market.

3.2.2 Tracking and discouraging potential 'noise trading' activity

In addition to the benefits of overall transparency, the main motivation cited for short sale disclosures is to track and discourage 'noise traders' from short selling. This is a concern for some asset owners and corporations, because they believe that short selling exerts downward pressure on share prices.

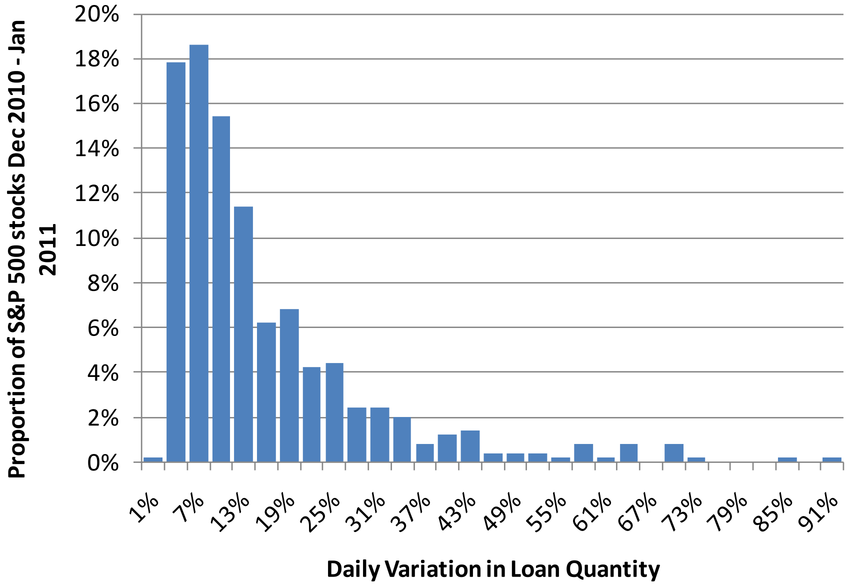
The data in Exhibits C and D suggest that, compared with the activities of long only funds, the scale of short positions is usually small. Long only funds, as the owners or managers of assets clearly have a vested interest in higher share prices, but are also the primary providers of lendable inventory which makes short selling possible.

This suggests that for most stocks, at most times, the impact of short selling will be minimal. However, it is possible that for thinly traded stocks, short selling can temporarily tip the balance against a stock. Recent research[1] using Data Explorers data shows evidence that this effect can be identified in smaller stocks, but the impact on prices is small and short lived.

This supports an exceptions based approach where rapid changes in positions can be immediately identified; with the option of public disclosure at the discretion of the regulator and the company involved.

The general value of “real time” reporting depends on the extent of intraday variation in short positions. Exhibit E shows the distribution of S&P 500 stocks over a recent 2 month period.

Exhibit E. Daily Variation in Loan Quantity for S&P 500 stocks, Dec 2010 – Jan 2011



Source: Data Explorers

This shows that about half of the S&P 500 stocks show daily variation of around 10% or less. This implies that high frequency intraday reporting will show limited variation in many stocks; which in turn suggests that exceptions based approaches (“a change in short position of more than x”) could be an efficient way of identifying unusual activity.

3.2.3. From the perspective of Lenders

For Lenders, the Benefit of real time public disclosure is minimal, because they typically report to trustees and investment committees on a monthly or quarterly cycle. Many asset owners (mutual funds, pension funds, and insurance companies) are willing to receive a fee from those hedge funds who short sell the long holdings of the asset owners.

Our data shows that most pension and insurance fund asset owners and mutual fund managers in the US are engaged in stock lending in some form. This also implies that most asset managers are willing to accommodate short sales in stocks where they have long holdings.

3.2.4. From the perspective of Borrowers

For Borrowers, real time short interest data is valuable because it helps them plan their loan inventory and avoid replicating the positions of other short sellers (the avoidance of price squeezes is a key element of risk control for short sellers).

3.2.5. From the perspective of Investment Managers

For Investment Managers, the value of real time short interest data depends on their time horizon.

Real time consolidated disclosure will be valuable for high frequency trading funds, providing them with a fresh set of data to mine for trading signals. For the majority of traditional long only funds, investment horizons of a month or more are common.

Recent research[2] using Data Explorers data shows that analytics which include short interest data can provide long term (12 month) signals for stock selection decisions; they also show that for most long only managers, a delay of two or three days in the publication of data has a negligible effect on the strength of a one month ahead signal.

This research also shows that Short Interest is, *in isolation*, one of the less valuable metrics for the investment manager; it needs to be viewed alongside the supply of stock available to cover short selling, the cost of borrowing, the source of demand and supply, and the traded volume in the underlying security. Disclosed data in this market needs to be placed in a broader context using appropriate analytics.

1.3 Potential unintended consequences of the short positions being made public in 'real time' to Data Explorers clients

3.3.1. Potential for systemic risk

The potential benefits of short selling have been described in detail by the Commission.[3] Recent research by Oliver Wyman[4] shows that *manager level public disclosure* can have a range of negative effects on markets – reduced liquidity, wider bid-offer spreads, increased volatility and negative returns. There is no equivalent study for *consolidated public disclosure;* but intuitively we would expect to see similar, but weaker, effects.

However, one key finding in the Oliver Wyman study is that manager level public disclosure results in an increased frequency of transactions. This may reflect a fresh set of transactions in reaction to disclosed data or some form of 'gaming' the disclosure rules. A number of European Governments[5] have expressed concerns about a potential link between public disclosure and market destabilization.

On the evidence presented here, hedge funds engaged in short selling are a small proportion of the market overall. It is possible that high frequency disclosure will result in an increased volume of trading; it is also possible that such an increase would lead to market instability; but it depends, critically, on the scale of such new, 'copycat' trading.

The impact on stability depends on the balance of two forces – the inhibiting effect of more disclosure on existing longer term large trades, and the disinhibiting effect on a larger number of smaller short term trades.

3.3.2. Potential increased vulnerability of publicly listed corporations arising from imitative short selling or sudden share price movements

Some corporations believe that short selling has the potential to artificially depress their share price, rendering them vulnerable to takeover; or even to bankruptcy, in the event that their credit rating and hence their funding costs are linked to the level of their share price.

For these corporations, high frequency public disclosure would allow them to identify when and to what extent their shares are being sold short. Public disclosure in these cases may however also fuel imitative short selling. In thinly traded stocks this might lead to a temporary depression in share prices, but the main impact is more insidious.

To quote former SEC Chairman Cox: "When an irrational panic is fuelled by false rumours that investors believe must be acted on immediately – lest everyone else get out first – market integrity is threatened"[6].

Private disclosure with a trigger that alerts affected corporations would be a more discreet approach to achieving the same result.

3.3.3. The required disclosure may not provide a full picture of the market

Much of the new short selling data which will be disclosed under the new guidelines will reflect a range of technical activities – hedging of derivatives and swaps, market making, convertible arbitrage, as well as the more controversial activity of directional shorting. Some, but not all, of this activity will be revealed by the 5 proposed flags.

3.3.4. Potential regulatory arbitrage by highly mobile financial institutions

Regulation under discussion, and in some cases already in force, in Europe currently proposes disclosure of manager level positions; France has recently announced thresholds for private disclosure in excess of 0.2% and public disclosure in excess of 0.5%. The SEC proposals for consolidated disclosure are popular with European money managers[7] and there is evidence that some European funds have changed their domicile to Hong Kong to take advantage of the private disclosure regime there.

3.3.5. Potential for reduced market activity including hedging

The public disclosure of this data in real time could potentially compromise proprietary trading strategies and therefore inhibit asset managers from engaging in certain activities such as hedging.

This point has been publicly noted by the SEC:

"A principal drawback of requiring investors to disclose publicly their short sales or short positions is that such disclosure could compromise proprietary trading strategies, as well as chill hedging activities. Hedging is socially valuable in that, among other things, it can encourage investors to take long positions, thus facilitating capital formation. More active trading strategies that rely on short selling also serve an important purpose, improving market quality by incorporating the more pessimistic views of short sellers into securities prices. To the extent additional short sale disclosure results in less short selling, markets actually may become less transparent, with securities prices reflecting fewer perspectives."[8]

2. Conclusions:

Customer feedback, academic evidence and analysis of Data Explorers data suggest the following:

- Real time disclosure provides improved transparency, although its primary value will be to high frequency traders.

- Many stocks have daily changes in short positions of less than 10%, suggesting that exceptions based short sale reporting might be more cost effective.

- Traditional managers tend to operate on longer time horizons and place less value on high frequency or real time data of this kind.

- Corporations show sporadic interest in short sale data, usually following a period of share price weakness, but Data Explorers have not found sustained interest in high frequency data from the Corporate sector.

- For some stocks, especially those with smaller market capitalization, disclosure of the proposed fields may lead high frequency traders to misinterpret the signal and may encourage 'copycat' activity, resulting in increased volatility and reduced market activity.

We recommend high frequency private disclosure, which places the majority of the cost of compliance on the short seller. We recommend low frequency public disclosure, which minimizes the public cost of collection and reporting but achieves the overall aim of regulating short selling and managing unintended consequences.

Appendix A. Biographies of Attendees from Data Explorers

Chris Hanson, Managing Director, Americas

Chris joined Data Explorers from Thomson Reuters in 2010, where he served as Senior Vice President and General Manager of Thomson Reuters Quantitative Analytics. Prior to this, he was Head of Sales and Marketing at Quantitative Analytics, Inc., a leading software and data provider to institutional investors that was purchased by The Thomson Corp. in 2006. Previously, Chris was Vice President of Sales at First Call, which developed the industry's first electronic delivery platform for brokerage research, and was a Senior Associate in the Financial Services group at PriceWaterhouseCoopers.

Julian Pittam, Managing Director, Global

Julian joined Data Explorers from Lehman Brothers in 2005. His work in the securities finance industry began at Bankers Trust in 1992 where he set up the European Fixed Income repo and lending books. He joined the repo desk in 1995 and set up the sales function for Bankers Trust International. Following two years in Hong Kong with Bankers Trust setting up the sales and marketing function of the Equity Finance desk, he then moved to Singapore with Bankers Trust for a further year. Once back in Europe for Lehman Brothers from 1999, Julian built and managed the Institutional Sales and Marketing business. In his final year there he was responsible for the Sales and Marketing of the Prime Broker and Institutional product in the UK and Scandinavia. Julian left Lehman Brothers in 2005 to join Data Explorers.

David Carruthers, Segment Director

David joined Data Explorers from Barrie and Hibbert in 2008 where he was a consultant for 12 years. He has worked with a number of US and European regulatory and industry bodies in the fields of portfolio risk, systemic risk, market microstructure and liquidity. He was retained as a consultant by Data Explorers since its inception in 2002. He joined the company full time in 2008 and now has global responsibility for the main business segments. He also has 10 years experience in asset management. He holds a PhD in Econometrics and is a member of the CFA Institute.

Simon Capp, North American Sales Director

Simon joined Data Explorers from Deutsche Bank in 2007 where he was a collateral manager. Simon has participated as an industry expert at various events and panels, joining regulators, partners and securities lending practitioners in Europe and North America. Simon is currently responsible for developing all aspects of North American business for Data Explorers. He received his Masters in Business Administration from Adelaide University in Australia and is a certified Financial Planner and Wealth Manager.

Appendix B. Bibliography

[1] Ringgenberg, M. 'Short Sales, Volatility, and Heterogeneous Beliefs', 2010

[2] Deutsche Bank Quantitative Research Team, 'Signal Processing: The Long and the Short of It', 2011

[3] SEC, Statement on Short Selling, Oct 2008

[4] Oliver Wyman, 'The Effects of Short Selling Public Disclosure Regimes on Equity Markets', 2010

[5] According to ISLA, Italy, Netherlands and Czech Republic are concerned about systemic risk due to disclosure.

[6] SEC, Statement by Chairman Cox for Wall St Journal, July 2008

[7] Oliver Wyman, 'The effects of short selling public disclosure of individual positions on equity markets' 2011

[8] SEC, Statement by Commissioner Troy Paredes, Oct 2009