May 23, 2009

I am writing in response to the proposed amendments to regulation SHO as published under File Number S7-08-09. I am an individual investor and independent trader who has never had any affiliation with an SEC regulated entity, other than as a customer or consumer.

I agree with the Commission's action re-examine the role and impact of short selling on equity markets and consider potential restrictions. However, after considering the Commission's proposal as published I am generally opposed to restrictions on short selling based upon price tests of any kind in what can be considered normal market conditions. At the same time I do favor restrictions on short sales in periods of extreme or unusual price declines either in the broad markets or in a particular security along with balancing restrictions on purchases in periods of unusual price advances. I also favor increased enforcement and regulation of short selling activities to eliminate potential abuses of short selling.

My comments follow in three sections, (1.) general comments on the role of short selling and its market impact, (2.) specific comments on the rules proposed in File S7-08-09, and (3.) additional considerations and recommendations.

Comments on the Role of Short Selling and Market Impact

The hallmarks of sound and healthy markets are openness, transparency, fairness, efficiency and liquidity. As explained in section II. Background on Short Sales Restrictions within Commission's notice, short selling provides the market with a number of benefits including maintenance of and increases in liquidity and pricing efficiency.

Fundamentally, there is nothing wrong with "selling short" a security in a sound and healthy market. There is nothing fundamentally wrong with borrowing inventory to secure the ability to sell to a willing buyer, provided that the inventory is indeed properly borrowed and the lender is fairly compensated for making the loan. Allowing potential sellers to borrow inventory to make sales to willing buyers increases the liquidity in that market and at the same time provides a source of revenue for the lender. Short selling is the appropriate market balance to leveraged long purchases where capital is borrowed by a buyer to increase his or her holdings in long positions. Both are comparable and balancing in their market impact and both are equally subject to abusive practices.

Arguments that short selling is "un-American" are misguided when securities markets are viewed as any other marketplace where potential buyers and sellers meet to conduct buy and sell transactions. Merchants throughout the world borrow inventory in order to conduct selling transactions to interested buyers. Short sellers of securities are no different. Unfortunately, the public at large has been misled to believe that the securities markets are capital appreciation mechanisms and generally fail to recognize these markets for what they are truthfully. Any rational study of price history in the equities markets of the United States considering either nominal prices or real value will reveal that there are regularly periods of both rapid and substantial price declines, as well as periods of sustained value decline, both real and nominal. Clearly these are not capital appreciation vehicles that the public so desperately wants them to be. These are markets, plain and simple, where selling needs to be as much a consideration as buying.

Markets in which potential buyers are allowed and encouraged to increase demand for the goods offered through borrowing to make purchases (leveraged long acquisitions) without a balance provided by equal allowance for sellers to borrow inventory to increase supply to meet the demand (short selling) are imbalanced and biased towards price increases. In such a market buyers encouraged to successively make purchases and increase demand while supply is being restricted by limiting sellers. A simple consideration of fair value reflects that sellers are being protected as buyers are being placed in positions of increasing risk. These are unhealthy and inefficient markets. Therefore any general or broad restriction on short selling should be met with a comparable restriction on leveraged long purchases. However, the comparable practice of borrowing by buyers and sellers promotes market health provided both are done with openness, transparency and fairness.

Similarly, arguments that short sellers "have no skin in the game" are also misguided. Sellers who take on the risk and obligation of borrowing to acquire inventory to bring to market have comparable involvement as those buyers who borrow to make purchases. An added element of short selling that is broadly missed by the public at large is that a short seller actually serves to increase demand for what is being sold. This comes from the fact that once a short sale is transacted the seller is immediately obligated to make a balancing purchase to return the inventory sold. As a result that short seller immediately becomes part of the pool of potential buyers. This is a position not shared by sellers who complete sales from their own inventory directly held. Hence while short sellers provide an immediate and temporary increase in supply, they ultimately function to increase demand providing support for prices.

I have personally attempted to deduce statistical correlations of price movement in markets of differences between periods where the former uptick rule was in place and in the period since its repeal. I have been unable to determine that negative price movements are exacerbated in a period without an uptick rule in place. Considering the fundamental role of short selling in a healthy market this observation should not be surprising.

While short selling is an important element in a healthy market system, it does have potential for abusive application. In securities markets these can and likely include attempts to manipulate prices to conduct "bear raids" and naked short selling in which a sale is made absent of proper possession or title to inventory to sell. In the interest of market health, transparency and fairness require that any such abusive practices be banned with significant penalty for anyone who engages in such practices.

Naked short selling is tantamount to fraud, and should be pursued and punished as such. Attempts to use short selling to manipulate prices for any purpose be it a bear raid or simply attempting to drive a weak competitor out of the marketplace are entirely inappropriate. I believe there are already regulations that prohibit fomenting a market and such practices should be treated according to those extant rules.

Specific Comments on Rules Proposed in File S7-08-09

In its present form I find the exceptions proposed in the notice so numerous and encompassing to the advantage of broker-dealers, market makers and large investment institutions as to be limiting in practice only to the individual investor or independent trader. Especially bothersome in its present form are the exceptions allowed for VWAP price programs whose sole purpose is to achieve price containment for a period of time while individuals enjoy no equivalent advantage. As proposed the only short selling activities that would be practically limited are those that would be made by individuals transacting in their own personal accounts at their own discretion. As such it would appear that the rules proposed would advantage major investment institutions at the expense of the individual investor and appear unfair to the public at large.

The issue properly at hand is then how to regulate short selling to thwart potential abuses while preserving the merits that it brings to the marketplace. With this question in mind I submit the following:

- Short sales should not be subject to a "bid test" that would limit such sales to advancing price conditions only. Such a test is an attempt to prevent price declines from an increase in supply that short sellers might bring, and as such is a move that restricts an open market from efficient price discovery. Further, in this age of decimalized prices at the once-cent and less level coupled with high frequency electronic transactions, a bid test is wholly ineffective. In the past when an "uptick" rule was in place, common trading platforms and trading algorithms were programmed to wait for the one-cent uptick and then execute immediately. At most such a rule serves to support prices at the once-cent level, which is meaningless in the context the environment that stimulated the proposed rule.

- Should short sales be restricted to a bid test, then to maintain efficient market balance leveraged long acquisitions should be equally subject to a similar bid test in the opposite direction.

- The Commission should develop a circuit breaker rule that limits or prevents sales of any kind in a market session for a particular security if that security's price exhibits an unusual negative price excursion within a period of either one day or one week (five successive days). Such an excursion should be based upon a statistical measure of that security's traditional price movement in percentage terms covering a period of not less than ninety-days or more than three years, and should be not less than two standard deviations of price movements in the matching time period (day or week). Short sales should not be uniquely subject to such a circuit breaker test. In fairness all sales should be equally limited.

- Should the Commission enact a circuit breaker test for sales of any kind, a balancing circuit breaker test for purchases of any kind should also be enacted under the same principles but for periods with price excursions in the advancing direction. Such a rule would serve to both protect the public from manipulative practices that lure unsuspecting buyers with advancing prices in the hopes of more of the same.

- Rather than attempting to curb short sales through an ineffective uptick rule, the Commission should consider a rule that limits the open short interest of any security to a limiting maximum percentage of the total shares available to the public (i.e., float) at the time of a short sale. A reasonable limit for any security would be in the range of one-third to one-half of the float. Such a rule would seriously restrict the potential for an effective bear raid or serious price manipulation.

- The Commission should consider rules that would allow for short sales only through registered broker/dealers or clearing agencies that actually have possession of the assets to be sold within their established inventory at the time of such sale and by a participant who has an established appropriate agreement for borrowing the assets with such an agent. Such a rule would prevent the practice of "naked shorting" by firmly establishing proper possession or title to sell requirements before a short sale could be entered.

- The Commission should consider changing the rules governing the settlement period for equity transactions form the current T+3 requirement to T+1 as is currently common with other securities and derivatives. Such a change would further serve to decrease the potential for naked short selling abuses and to help identify those who had no intention of completing delivery in a short sale.

Additional Considerations and Recommendations

Part of the impetus to reconsider potential restrictions on short selling is reportedly the erosion of investor confidence and the belief that imposing restrictions on short selling would restore investor confidence. Without doubt investor confidence is vital to the health and stability of open and free capital markets necessary for the formation of investment capital necessary for national economic wellbeing. The belief that a restriction on short selling, however, will restore investor confidence is misplaced.

Investor confidence has been eroded because of significant and often hurtful declines in values of personal investment portfolios. Confidence was lost when investors experienced a result that they did not expect or worse thought could not happen. While generally unexpected the recent steep decline of equity values, as well as numerous other investment asset values including real estate, was foreseeable, predicted by more than a few, and should have at least been seen as a potential risk by every investor.

The notion that restricting short sales would be effective in restoring investor confidence can only be valid if such restrictions would be certain to prevent such losses in the future. As market price history shows, such an effect will not happen. In the long period of an uptick rule, equity prices experienced significant periods of notable and rapid decline with enduring periods afterwards before pricing returned to levels associated with the previous highs from which the declines originated. In spite of numerous attempts by many no one has been able to show that the recent steep declines experienced in U.S. equity markets has either been a result of or was made extreme by short selling. Even with a ban on short sales of specific financial services issuers the market ultimately found what it perceived to be fair value, which in many cases was lower than the market valuations at the time such restrictions were implemented on “an emergency” basis. Restricting short selling on the basis of price movement cannot be shown to have any material effect on price movement and the fair value that an open and transparent market will ultimately seek.

If the Commission wishes to expand its current stated mission to include *restoring and maintaining investor confidence* then it should direct at least part of its attention to investor understanding of the proper function and use of efficient markets as well as risk identification and risk management when participating in those markets. As noted previously the investing public has been misled to view U.S. securities markets as capital appreciation vehicles. While these markets provide a rich and abundant opportunity for individuals to build and grow wealth, success in doing so requires that participating investors function as full market participants, both as a buyer and as a seller as market pricing and values dictate, with a well grounded appreciation of the associated risks.

In closing I trust that the Commission will consider and weigh my comments fairly and seek a rational decision based upon sound market fundamentals and empirical data, and avoid succumbing to the tremendous political and ill-informed popular pressures to which it is subject. I trust that the Commission will decide and act consistent with its stated mission, *to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation*. As I have attempted to make clear in my comments, short selling is an important component of fair, orderly and efficient markets. Fundamentally, restricting short selling on the basis of price movements is an attempt to bias prices to higher levels and as such is potentially injurious to buyers who seek price improvement. Such a bias flies in the face of market efficiency and market fairness. Moreover any restrictions placed on short selling activities should be matched with a balancing restriction on leveraged long purchasing activities to maintain proper market balance. Consistent with its mission the Commission should pursue regulations that prevent potential abusive short selling practices including naked short selling and efforts in any form to manipulate prices. Further if the Commission seeks to restore investor confidence then efforts to increase investor education and understanding as well as increased regulatory attention to the general investment guidance offered by established institutions serving the public at large should be considered.

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