June 17, 2009

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

Re: S7-08-09

Dear Ms. Murphy:

Thank you for allowing Group One Trading, L.P. ("Group One") the opportunity to comment on the proposed amendments to Regulation SHO, that would place restrictions on the short selling of stocks. As an introduction, Group One is a proprietary options market maker that makes markets on 5 Exchanges and is a Specialist, Designated Primary Market Maker, or Lead Market Maker in about 3,000 options classes. We respectfully would like to make the following points expressing our concerns over the proposed rules:

I. Current Rule 204T already addresses the problem of naked short selling and the additional regulations are costly with minimal to no benefit.

The current 204T requirements already address the vast majority of the issues relating to naked short selling. Since those rules have been enacted, the number of Reg SHO securities has decreased dramatically, and as a result naked short selling has greatly diminished. The number of threshold securities has been reduced from 582 in July 2008 to 68 as of May 5, 2009.[1] Since curbing naked short selling appears to be the main objective of the SEC, it seems as if that goal has been achieved. Additional restrictions would only reduce legitimate short selling activity which is a vital part of any capital market's existence. There seems to be a general consensus among the public that when a stock's price decreases, it's a negative event. On the contrary, we would argue that artificially inflated equity prices serve to act as a short term benefit, but turn into long term problems. The capability for the marketplace to set a stock price that both the short and long side can access, is paramount in the overall health of our capital markets. There are countless examples that serve to illustrate the damage that can be caused by limiting legitimate short selling. One recent example is GMGMQ (General Motors). The automotive company, which recently filed for chapter 11, is currently trading for approximately $1.60.

[1] GAO-09-483, "Regulation SHO Recent Actions Appear to Have Initially Reduced Failures to Deliver, but More Industry Guidances Is Needed", May 2009.

This clearly does not reflect the actual market price for the security, but rather a short squeeze where no one can deliver the shares and so no one can hold onto a short position. The conclusion is that actions which reduce the naked short selling abuses should be embraced while other broader limitations on short selling are detrimental to the capital markets as a whole.

2. The Commission's proposals do not efficiently achieve the goal of preventing abuses from short selling or naked short selling.

If the SEC is compelled to put further restrictions on either short selling or naked short selling, to help prevent abuses of the system, there are better and more efficient ways to achieve this goal. The data regarding both long and short firm positions already exist and are readily available. If the SEC and/or the investing public are truly worried about abuses in short selling, we believe the SEC should impose more stringent reporting requirements on short selling in general, and then monitor and surveil for abuses. The SEC could require the public disclosure of short positions by broker/dealers and institutional investors, similar to the reporting requirements of long position reporting under sections 13d and 13g.This would increase transparency, result in a relatively low cost alternative to implementing an uptick test, and would have a much more directed effect through identifying and stopping the abusive behavior. More importantly this proposal would not impose a cost on the rest of the legitimately functioning marketplace. There are many other variations of this concept, but the basic premise remains the same that taking a targeted approach under already established rule will more effectively put a stop to unwanted behavior.

3. The elimination of the OMM exemption will widen option spreads and hurt liquidity.

We strongly believe in the need to include an option market maker exemption into the uptick rule (similar to the proposal under the circuit breaker halt scenario), should the SEC deem that none of the previously discussed arguments are valid. As an equity options market maker, we are required to make a two sided quote, which leaves the market maker un-hedged and exposed to market risk. Because of this, we as market makers must have the ability to sell stock short to hedge our position (if the MM either buys calls, sells puts, or some combination of the two). If option market makers are unable to sell stock (because the stock is down-ticking), then we'll be unable to hedge our positions. This problem will require that market makers incorporate this factor into our pricing models, which will unquestionably widen the quoted spread. Even if the spread is only widened marginally, there will be a substantial cost involved in implementing this program. If spreads widened out by only ¼ of a penny, which isn't an unreasonable assumption, it would cost the investing public roughly $900,000,000 per year (based on approximately 3.6 billion contracts traded per year across all equity options exchanges). This assumption is validated by a review of the markets in Reg SHO issues where MM's couldn't hold short stock - the spreads widened considerably when they went on the Regulation SHO list. Further, if you look at the markets when the SEC imposed the short stock limitations in September 2008, it's clear that spreads widened substantially when the most draconian measures were going to be implemented (September 19th). It's also clear that spreads widened when stocks were placed on a "cannot short" list even prior to September. Finally the trade sizes on the "long delta" side of the trade by market makers will likely decrease. This too would cause a disruption by reducing liquidity for the customers of options exchanges. There are definitely more cost effective ways of achieving the desired results.

4. Markets have changed substantially since the elimination of the uptick rule.

The Commission and general public seem to imply the rule is harmless because "it was in place before, and re-implementing it wouldn't be a big change". That line of thinking fails to take into consideration some major structural changes that have taken place since the last time we had up-tick rules. The first change is in the options market place, where spreads have reduced considerably since the uptick rule was last in place. In addition volume in the options market has increased from 1.50B contracts in 2005 to 3.58B contracts in 2008. This makes it even more likely that you may see the spread increase as a result of this change (ie, the elimination of the previous uptick rule was one of many factors in the reduction of spreads we have seen). Regulation NMS now exists, and the cost of processing the required data and complying with the proposed requirement would be onerous. These are just a few of the changes that make a comparison ineffective when trying to compare the current market to that of three years ago.

Conclusion

For the reasons set forth above, we believe the Commission should not adopt the proposed amendments to Regulation SHO restricting short selling. Group One would like to see Reg. 204T continue to address the issue of abusive naked short selling. If the Commission believes in the need to enact additional regulation, we would recommend taking a more proactive stance towards monitoring and requiring short position reporting to help address and target the truly abusive short sellers, and not the marketplace as a whole. Lastly, if enacting an uptick rule, we feel that it's necessary to include a market maker exemption or otherwise risk a substantial "disruption" in the options markets in the form of less liquidity and wider spreads. We agree with the concept of eliminating abusive short selling, and believe the Commission should act in the most effective and efficient manner of this endeavor and all market regulation. We would be happy to discuss this further with the Commission and its staff.

Very truly yours,

John Gilmartin
Co-CEO

Ben Londergan
Co-CEO