



June 18, 2009

Elizabeth M. Murphy
Secretary
U.S. Securities and Exchange Commission
100 F Street NE
Washington, D.C. 20549

Re: File Number S7-08-09, Amendments to Regulation SHO

Dear Ms. Murphy:

Allston Trading LLC (“Allston”) greatly appreciates the opportunity to comment on the Securities and Exchange Commission’s (the “Commission”) proposed amendments to Regulation SHO under the Securities and Exchange Act of 1934 (the “Exchange Act”)¹. Allston is a high-frequency algorithmic trading firm that submits electronic orders directly to various exchanges and ECNs. The Firm is a registered broker-dealer under Section 15 of the Exchange Act and does not engage in any customer business; all of its trading is exclusively proprietary in nature. Allston generally acts as a market maker in the securities markets; adding a significant amount of liquidity without taking a particular view on the direction of the market or a particular security. When the firm enters into a short position, it is temporary in nature and is usually hedged by a long position. As a firm actively engaged in securities trading, Allston, like many other industry participants, was forced to adapt very quickly to the emergency orders the Commission released last summer and is pleased that the Commission is conducting a thorough evaluation of these proposed amendments prior to taking any actions that could negatively impact the market.

The Commission’s proposal indicates that restoring investor confidence is the key objective it hopes to achieve with the proposed amendments. Investor confidence has been shaken during these difficult financial times and the public is looking for the Commission to take action to ensure investors are protected. Some investors have been very vocal in their calls for reinstatement of a market wide price test. Those calls are understandable given the public’s familiarity with Rule 10a-1 of the Exchange Act (the “Uptick Rule”) which was in place for nearly 70 years prior to its removal in 2007. The public, however, seems to be less familiar with the Commission’s evaluation of the market wide price tests conducted prior to the removal of the Uptick Rule. As noted in the Commission’s findings in 2007², which cited the Commission’s own study along with the results of various academic studies, and in the

¹ Securities Exchange Act Release No. 34-59748, (April 10, 2009), .74 Fed. Reg. 18042 (April 20, 2009) (the “Proposed Amendments”).

² Economic Analysis of the Short Sale Price Restrictions Under the Regulation SHO Pilot, Office of Economic Analysis, U.S. Securities and Exchange Commission, (2007).

Commission's recent rule proposal³, the Uptick Rule did not prevent short sales in extreme down markets and did limit short selling in up markets. After a thorough evaluation, the Commission concluded that there was little justification for maintaining the market wide price tests. We believe it is vitally important that the Commission consider the results of these studies as it determines whether reinstating a market wide price test is the appropriate action at this juncture. It's important for the Commission to evaluate all possible alternatives for addressing the problems at hand and to select the option that is most likely to be effective; not simply the choice that is most well known to the general public.

The Commission should closely examine the numerous studies that have been conducted to analyze the impact of the Commission's Emergency Order⁴ banning short selling of certain financial firms in September 2008. The consensus seems to indicate that the short sale ban was actually harmful to the markets and in turn to the investing public. One such study conducted by Ekkehart Boehmer, Charles M. Jones and Xiaoyan Zhang indicates a "severe degradation in market quality, measured by spreads, price impacts, and intraday volatility," with little to no impact on the price of the stocks⁵. This is likely due largely to the fact that many market participants that regularly provide liquidity to the markets, including Allston, were forced to halt trading completely in the affected symbols. Even the Commission's former Chairman, Christopher Cox, has indicated that, in hindsight, the ban was a mistake. "The costs [of short selling ban on financials] appear to outweigh the benefits".⁶ Restricting a liquidity provider's ability to sell short hinders their ability to effectively make markets and hedge their positions. These firms add value to the market by making it more efficient, narrowing spreads and providing better prices to the individual investor. Although unintentional, it seems the Commission may not have been acting in the best interest of investors when it prevented firms such as Allston from providing this service.

It is the Commission's responsibility to determine the underlying cause of investors' loss of confidence and to address those issues directly. Again, we applaud the Commission's attempt to fully understand this crisis by soliciting input from an array of market participants, including individual investors, trading firms and exchanges, as well as members of the academic community. It is our belief that Commission has already done the work of approving rules necessary to prevent bear raids, naked short selling and fails-to-deliver. Sufficient rules are already in place. The current problem lies not in a lack of rules, but a need for strong enforcement of those rules. Rule 204T was a significant step in addressing the issue of fails-to-deliver and the Commission must ensure that 204T, as well other

³ See Proposed Amendments, p.12-15,

⁴ Release No. 34-58592 (September 18, 2008).

⁵ Boehmer, Ekkehart, Jones, Charles M. and Zhang, Xiaoyan, Shackling Short Sellers: The 2008 Shorting Ban (June 1, 2009). Available at SSRN: <http://ssrn.com/abstract=1412844>

⁶ See Rachelle Younglai, SEC Chief Has Regrets Over Short Selling Ban, Reuters, Dec 31, 2009, available at <http://www.reuters.com/article/newsOne/idUSTRE4BU3GG20081231>.

components of Regulation SHO, are diligently enforced. Based on our experiences and our contacts with other market participants, we fully believe that the majority of broker-dealers make every effort to comply with SEC and exchange rules. For example, Allston has invested significant time and resources over the past several years to ensure our compliance with Regulation SHO and the more recently released, Regulation NMS. However, it is apparent that some industry participants have chosen not to comply with these regulations and we fear there are no repercussions for their actions. Allston often observes activity in the markets that appears to violate SEC or exchange rules and there is no indication that any regulatory action is being taken. Investor confidence can be restored by stepping up enforcement for existing rules, specifically Regulation SHO and Regulation NMS.

As noted above, Allston does not believe implementing any of the alternatives laid out in the current proposal would be a prudent course of action. However, we do recognize that the Commission may be compelled to act because of public and political pressure surrounding this topic. Our preference, should the Commission deem it is necessary to select one of these amendments, would be the circuit breaker which triggers a modified uptick rule. We are in agreement with the Commission that bids are more reflective of actual market prices than the last sale and, as such, a modified version of the Uptick Rule is more appropriate for today's marketplace⁷. Additionally, we believe the proposed 10% threshold for the circuit breaker is reasonable at this time. The circuit breaker with the modified uptick rule limits the impact of this change to only those stocks experiencing a decline while allowing legitimate short sale activity to continue. The market wide approaches and a circuit breaker with a short sale ban will hamper legitimate short selling thereby decreasing liquidity in the market overall causing wider spreads and making trading for all investors more costly. The circuit breaker with a modified uptick component would be the least disruptive alternative and would limit the unintended consequences that always present themselves after significant rule changes are implemented.

The Commission should also strongly consider exemptions for bona fide market making activity and all activity in exchange traded funds ("ETFs"), regardless of which alternative it chooses to implement. Participants acting in a market making capacity add necessary liquidity to the markets. The service they provide narrows spreads and is in the best interest of investors. Traders who would benefit from a market maker exemption also understand that with such an exemption comes a responsibility to the markets. Those obligations are met by providing regular and continuous quotes at or near the best bid or offer. Investor confidence will be further eroded should the Commission make rules that will prevent a market makers' ability to provide necessary liquidity and improved prices.

Given the purpose of these proposed amendments, we believe an exemption for ETFs is also appropriate. ETFs are essentially a basket of stocks based on a particular group or sector of the market. Bear raids, like those the Commission's rules are designed to prevent, are

⁷ See the Proposed Amendments, pg. 6

Elizabeth M. Murphy
June 18, 2009
Page 4

typically focused on individual companies and are much less likely to occur across entire sectors. Restricting short selling of ETFs also prevents a natural arbitrage which again would reduce liquidity in the market and lead to a widening of spreads. Any changes made that would lead to less efficient markets or a reduction in liquidity would contradict other measures the Commission has implemented over the last several years to narrow the spreads.⁸ Further, ETFs are very similar to futures products so it creates an inconsistency for the Commission to restrict price discovery on the ETFs when it is unable to do the same on the futures. Finally, some ETFs are commodity based and to include them in a rule directed at preventing equities bear raids makes little sense.

It is clear from the Commission's proposal that a great deal of thought has gone into the five options presented, the numerous possible exceptions to each option and the open questions to the public about the impacts of these proposals. Again, we would like to commend the Commission for its thoughtful approach to this matter. However, it's extremely difficult for industry participants to determine the impact of these various proposals at this time due to the large number of variables yet to be determined. We view this proposal to be more of a concept release in its current state than a rule proposal. As such, we would hope that the Commission would engage in a future comment period on the rule proposal once it has determined which option, if any, it plans to implement and the details as to how it hopes to do so. We look forward to the opportunity to comment further on proposed exceptions, implementation requirements and prohibition versus a policies and procedures approach at a future date should the Commission pursue an additional comment period on the proposed amendments.

If you have any questions or require any additional information, please contact the undersigned at (312) 663-7111. Thank you for your attention to this request.

Sincerely,

William Connell
President & CEO
Allston Trading LLC

⁸ Examples of the Commission's measures include penny pricing in options, decimalization in equities and the order handling rules.