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June 18, 2009

Elizabeth M. Murphy
Secretary
U.S. Securities and Exchange Commission
100 F. Street, NE
Washington, DC 20549-1090
By email: rule-comments@sec.gov

SUBJECT: Proposed Rule for Amendments to Regulation SHO, Release No. 34-59748

Dear Ms. Murphy:

I. Introduction

General Electric Company ("GE") appreciates this opportunity to comment on the Securities and Exchange Commission's (the "Commission") proposed rules described in Exchange Act Release No. 59748, Amendments to Regulation SHO (the "Proposing Release").[1] We commend and support the Commission's focus on the appropriate regulatory treatment of short selling, particularly during this time of heightened market volatility and deteriorating investor confidence.

GE is a diversified technology, media and financial services company, with products and services ranging from aircraft engines, power generation, water processing and security technology to medical imaging, business and consumer financing, media content and industrial products. Our financing unit, GE Capital, services consumers, retailers, and businesses, with products and services such as financing and equipment leasing to the air and rail transportation, energy and water process technologies industries; private-label credit cards, personal loans, mortgages, deposit and saving products, and credit insurance; commercial mortgages and loans; and loans and leases for premises and equipment. We provide essential liquidity to companies, consumers, and projects, and we rely on efficient and well-functioning markets to fill that role.

We strongly believe the Commission should take the appropriate steps to ensure that short selling is not used, solely or in combination with other actions, to improperly harm the financial reputation of companies and create a systemic risk to the global financial system.

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1 Exchange Act Release No. 5874859748 (Apr. 10, 2009).

Abusive short selling has caused real and lasting damage to the national economy and the marketplace. Some traders and speculators have been creating false signals in the marketplace about the financial health of companies. In some cases, these trading strategies have affected the fundamental operations of the targeted companies, and threatened their ability to survive. By excessively underpricing stocks or using derivative securities to cast doubt on credit, they can demoralize employees, drive away suppliers and customers, prevent access to capital and destroy an otherwise productive enterprise.[2]

The practice of short selling serves a legitimate role, such as aiding liquidity and price discovery. However, any legitimate functions it may have are absent in the trading strategies that use short sales to intentionally drive down a stock price. Short selling does not help the liquidity of a precipitously declining stock, since there are already more sellers than buyers of the security, and short sales only increase the illiquidity problem. Moreover, short sales in such situations do not further "price discovery," as the downward pressure on the stock is primarily based on the artificial sell-side pressure created by short sales in the first instance.

We urge the Commission to adopt a short sale price test based on the national best bid, which is similar to the proposed modified uptick rule described in the Proposing Release. To ensure the effectiveness of any adopted rule, we recommend that the Commission take the following actions:

- Implement the proposed modified uptick rule based on the national best bid in the form of both the "policies and procedures" approach described in the Proposing Release and the "straight prohibition" approach presented in connection with the proposed uptick rule; and

- Make further necessary reforms that will help prevent manipulative and abusive trading strategies, including adopting Rules 204T and 10a-3T on a permanent basis and expanding the disclosures required in connection with short sales, credit default swap ("CDS") purchases and synthetic investments that simulate short positions.

II. Market Conditions Require SEC Action

Over the past 18 months, the financial markets have experienced serious disruptions and continue to face significant challenges. As the Commission recognized in its emergency orders issued from July to September 2008, the possibility of "sudden and excessive fluctuations of securities prices" and "disruption in the functioning of the securities markets" pose serious threats to fair and orderly securities markets, and to the thousands of companies relying on these markets for access to capital.[3] The extreme volatility in the financial markets, the collapse of major financial institutions such as Bear Stearns and Lehman Brothers, and media reports of bear raids and market manipulation through the use of derivatives such as CDS have shaken investor confidence. In this environment, small investors, as well as large institutional investors have expressed concerns about market manipulation and abusive trading practices intended to drive stock prices to abnormally low levels.

Financial institutions are especially vulnerable to high volatility and rapid price decline. These companies depend heavily on short-term liquidity from the overnight and repurchase markets, while

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2 Opening Remarks ofAssoc. Prof. James J. Angel, Georgetown Univ., Opening Remarks at the SEC Roundtable on Short Selling (May 5, 2009), available at http://www.sec.gov/comments/4-581/4581-2.pdf.

3 See, e.g., Exchange Act Release No. 58591 (Sept. 18, 2008); Exchange Act Release No. 58166 (July 15, 2008); Exchange Act Release No. 58572 (Sept. 17, 2008).

their loan assets are typically held at much longer maturities.[4] As a result, mispricing on the downside is more damaging than on the upside for these companies and the overall market.[5] At the very least, a company's cost of capital will increase, and in a worst case, the company's counterparties will withdraw.[6] Thus, the volatility results in more than just a decreased stock price, but also affects the way businesses function.

Opponents of increased regulation of short selling often cite the need to protect high-volume, high-frequency trading.[7] While the ease of trade execution for market participants is certainly one factor the Commission may consider in formulating its approach to short sale regulation, speed and volume should not come at the expense of a fair, transparent, and orderly market.

III. Adopt the Proposed Modified Uptick Rule on Both a "Policies and Procedures" and a "Straight Prohibition" Basis

A. Need to Reimplement Price Tests

GE supports the adoption of a price test for short sales in a form similar to the proposed modified uptick rule advanced by the Commission in the Proposing Release. Price tests have never been designed to eliminate short selling, but instead to moderate and mitigate the effects of the practice. For the nearly 70 years before the Original Uptick Rule was repealed, price tests restricting short sales helped to strike the appropriate balance between allowing legitimate short selling and preserving market integrity.[8] Restoring a price test similar to the proposed modified uptick rule would facilitate the appropriate use of short selling, and prevent it from existing as a tool for market manipulators.

In July 2007, the Commission repealed the Original Uptick Rule and added Rule 201 of Regulation SHO, which prevented any self-regulatory organization ("SRO") from imposing a price test.[9] However, the dramatic change in market conditions since the repeal of the Original Uptick Rule has challenged the rationale behind its removal. Without any form of price test, stocks in declining markets are particularly vulnerable to groups of short sellers piling on after each other. By executing rapidly consecutive short sales at successively lower prices, some traders and speculators are able to drive the price of a stock to abnormally low levels and, in so doing, cause panic among other market participants. Numerous financial, economic, and political leaders, including Federal Reserve Board Chairman Ben Bernanke, Warren Buffet, and others, have called for reinstatement of an uptick rule or price test, and we take this opportunity to join them.

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4 Andy Kessler, Op-Ed., Have We Seen the Last of the Bear Raids? Wall St. J., Mar. 26, 2009.

5 George Soros, Op-Ed., One Way to Stop Bear Raids, Wall St. J., Mar. 23, 2009.

6 See id. and George Soros, One Way to Stop Bear Raids, Wall St. J., Mar. 23, 2009.

7 See, e.g., Letter from Dan Mathisson, Managing Director, Credit Suisse Securities USA, LLC to Elizabeth Murphy, SEC (Mar. 30, 2009), available at http://www.sec.gov/comments/s7-08-09/s70809-276.pdf.

8 Former Rule 10a-1 of the Exchange Act (the "Original Uptick Rule") prohibited short sales of listed securities below the price at which the last sale thereof, regular way, was reported, or at such a price, unless that price was higher than the preceding different price reported. See 17 C.F.R. § 240.10a-1 (removed and reserved, effective July 3, 2007). Beginning in 1994, trades executed by members of the National Association of Securities Dealers ("NASD") or their customers were subject to a similar bid test (the "NASD bid test"), which prohibited short sales at or below the best bid price. See Former NASD Rule 3350, providing that short sales in Nasdaq Global Market sSecurities must not be effected at or below the current national best (inside) bid when the current national best (inside) bid is below the preceding national best (inside) bid. When Nasdaq became a national securities exchange, the SEC granted its requested exemption from Rule 10a-1 and approved its proposal to adopt Nasdaq Rule 5100, similar to former NASD Rule 3350, which continued to regulate short sales in Nasdaq Global Market Securities. Nasdaq's Capital Market Securities (formerly Nasdaq SmallCap Securities) continued to trade without being subject to a price test. See Exchange Act Release No. 53128 (Jan. 13, 2006).

9 Exchange Act Release No. 34-55970 (June 28, 2007).

To be effective in today's markets, any price test rule that is implemented must take into account "synthetic" short sales. A price test on short sales could be easily circumvented, for example, through a combination of selling calls and buying puts with the same strike price and expiration date. The Commission should not allow circumvention of the proposed price test rule through the use of synthetic short sales.

B. A Bid Test is Appropriate in Today's Market

As described in the Proposing Release, the proposed modified uptick rule would use the national best bid as a reference point for short sale orders,[10] requiring that trading centers[11] "'establish, maintain, and enforce written policies and procedures reasonably designed to prevent the execution or display of a short sale order in a covered security at a down-bid price.'"[12] Down-bid price is defined as one "'that is less than the current national best bid or, if the last differently priced national best bid was greater than the current national best bid, a price that is less than or equal to the current national best bid.'"[13]

We support the proposed modified uptick rule's use of a "bid test," based on the national best bid, rather than a short sale test based on the last sale price. There is a 90 second window for the reporting of sales of a security, which are then published in reporting sequence rather than trade sequence. Thus, a price test based on the last reported sale price may not accurately reflect the market for heavily traded securities.[14] Additionally, the bid test would alleviate many of the difficulties the Original Uptick Rule experienced due to the increasingly rapid nature of the electronic trading environment. Notably, a bid test would permit the use of electronic trading platforms that effect trades at prices based on the national best bid and offer (such as automated matching systems that execute trades at the midpoint of the bid-offer spread). [15] Because this bid-offer spread-based price is determined without regard to (and may be less than) the last sale price, the Original Uptick rule required numerous exceptions for such systems.[16] Since these systems are designed such that trades will occur at prices above the national best bid, a bid test would eliminate the need for such ad hoc exemptive relief.[17]

C. Any Price Test Should Combine the "Policies and Procedures" and "Straight Prohibition" Approaches

We believe that a price test based on the national best bid should be implemented through a combination of the "policies and procedures" and the "straight prohibition" approaches discussed in the Proposing Release.

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10 Proposing Release at 29.

11 A "trading center" means a national securities exchange or national securities association that operates an SRO trading facility, an alternative trading system, an exchange market maker, an OTC market maker, or any other broker or dealer that executes orders internally by trading as principal or crossing orders as agent. See infra note 11 and supporting text. See Proposing Release at 7, FN 7 n10.

12 See Proposing Release at 29, quoting Proposed Rule 201(b)(1) at 249.

13 See Proposing Release at 29-30, quoting Proposed Rule 201(a)(2) at 249.

14 See Proposing Release at 40.

15 See Proposing Release at 43.

16 See, for example, letter from James A. Brigagliano, Then-Acting Assoc. Dir., Div. of Mkt. Regulation, to Alan J. Reed, Jr., First Vice President and Dir. of Compliance, Instinet Group, LLC (June 15, 2006), available at http://www.sec.gov/divisions/marketreg/mr-noaction/instinet061506.pdf, granting conditional exemptive relief from Rule 10a-1 for trades executed through Instinet's Intraday Crossing System, which prices orders at the midpoint of the consolidated national best bid and best offer during pre-set one minute pricing windows. See also letter from James A. Brigagliano, Then-Acting Assoc. Dir., Div. of Mkt. Regulation, to Anitra T. Cassas, Esq., Wilmer Cutler Pickering Hale and Door, LLP, (Apr. 22, 2005), available at http://www.sec.gov/divisions/marketreg/mr-noaction/itg042205.htm, granting similar exemptive relief for ITG, Inc.'s POSIT matching system.

17 See Proposing Release at 43.

As described in the Proposing Release, the proposed modified uptick rule would be implemented by requiring trading centers to establish, maintain, and enforce written policies and procedures reasonably designed to prevent the execution or display of a short sale order of a covered security at a downbid price. [18] A similar requirement would apply to broker-dealers, who may mark a short sale order of a covered security "short-exempt" in reliance on policies and procedures that are reasonably designed to prevent the incorrect identification of orders priced in accordance with the requirements of the proposed rule.[19]

A "policies and procedures" approach would be consistent with the order protection rule of Regulation NMS, and should be relatively straightforward to implement. Additionally, it would permit trading centers the flexibility to tailor such policies and procedures to their particular markets, and permit broker-dealers the option to manage their order flow. The Commission would be able to monitor and enforce the trading centers' compliance with the "policies and procedures" through its enforcement authority over SROs under Section 19(h) of the Exchange Act.[20]

However, we believe that "any policies and procedures" approach should be supplemented and reinforced by the prohibition approach.[21] The Commission contemplated such a strategy in the Proposing Release, stating that the proposed modified uptick rule "could ultimately be implemented through a policies and procedures approach or through a prohibition approach or some combination thereof" and that "the approaches could be combined so that persons are prohibited from selling short on a down-bid and trading centers are also required to have reasonable policies and procedures to prevent the execution or display of a short sale on a down-bid."[22]

A prohibition on short sales based on a bid test is familiar to market participants, as NASD rules used a similar approach from 1994 to 2007. In addition, supplementing the "policies and procedures" approach with the straight prohibition approach will give the Commission direct enforcement authority over violations, rather than limiting its authority to monitoring the respective policies and procedures of the SROs or broker-dealers. This is particularly necessary in the case of a bid test (as compared to a price test based on last sale price) because a bid is more easily manipulated than the price (which is based on an actual transaction).

The Commission has previously adopted a combined approach with respect to Rule 204T, when it supplemented a requirement with the recommendation that participants adopt policies and procedures to help comply with such requirement, and stated that it intended to monitor participants' policies and procedures to determine whether the policies and procedures were effective in ensuring compliance.[23]

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18 See Proposing Release at 247, citing Proposed Rule 201(b)(1), Proposing Release at 247.

19 See Proposed Rule 201(c), Proposing Release at 248.248, citing Proposed Rule 201(c).

20 15 U.S.C. § 78s (West 2009).

21 The Prohibition approach would provide that: "No person shall, for his own account or for the account of any other person, effect a short sale in a covered security, if trades in such security are reported pursuant to an effective national market system plan and information as to such trades is made available in accordance with such plan on a real-time basis to vendors of market transaction information, at a down-bid price." (with conforming exceptions and implementation language).

22 Proposing Release at 8, FN 8 and n11.

23 See Exchange Act Release No. 58563 (Sept. 17, 2008); Exchange Act Release No. 58773 (Oct. 14, 2008).

IV. Make Rule 204T of Regulation SHO Permanent and Require More Timely Reporting of Fails to Deliver

We strongly believe that the Commission should adopt Rule 204T of Regulation SHO on a permanent basis, as it provides critically necessary restrictions on naked short selling. Initially adopted as an emergency order in September of 2008, Rule 204T was implemented as an interim temporary final Rule 204(T)(a) just one month later.[24]

The evidence indicates that Rule 204T has been effective. Following elimination of the options market-maker exception in Rule 203 of Regulation SHO and implementation of Rule 204T, there was a 47 percent decline in fails to deliver across all securities and 63 percent for threshold securities.[25] However, the reporting of fails to deliver should be disseminated more often. Currently, the Commission disseminates the information it collects regarding daily fail volume on a quarterly basis. Reporting such information more frequently, such as weekly, will enable issuers harmed by excessive fails to deliver to quickly identify and address the problem.[26]

V. Require Greater Disclosure by Short Sellers

The Commission's proposals to consider restrictions on short selling represent an important and necessary step in addressing certain abusive short selling practices. However, further action beyond the implementation of a short sale price test is needed in order to restore investor confidence in the market. The Commission should mandate enhanced disclosure of short selling and related trading strategies so as to moderate the dramatic effect these strategies have on the price of a security and the perceived value and financial health of the reference company.

Specifically, we urge the Commission to undertake regulatory reform through the rulemaking process, and, if necessary, by advocating to Congress for explicit authority to require greater disclosure by short sellers in several key areas. We recommend that short positions meeting a minimum threshold should be disclosed to the public, along with disclosure of any contracts, arrangements and understandings and relationships entered into by the reporting entity with respect to those shorted securities. While some professional traders will likely argue against such a rule as diminishing their competitive strategy, we believe that this burden will be vastly outweighed by the benefit to the marketplace of increased disclosure and transparency. These expanded disclosure items would not be intended as a means of revealing ordinary and routine trading operations. Indeed, institutional investment managers are already required to regularly disclose on Form 13F their long holdings in equity markets as well as various puts or calls purchased in the options

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24 Exchange Act Release No. 58563 (Sept. 17, 2008). Rule 204T requires short sellers and their broker-dealers to deliver securities by the close of business on the settlement date (generally "T+3" or three days after the trade date) and imposes penalties for having "fail to deliver" positions in any equity security. Market participants and broker-dealers that are noncompliant with Rule 204T are prohibited from further short sales in the same security unless the shares are located and pre-borrowed. See Temporary Rule 204T(a), 17 CFR 242.204t (West 2009).

25 See Memorandum from the OEA, Impact of Recent SHO Changes on Fails to Deliver to OEA Files (Mar. 20, 2009), available at http://www.sec.gov/comments/s7-30-08/s73008-107.pdf. Note that a "threshold security" is defined by Regulation SHO as an equity security of the issuer registered under Section 12 of the Exchange Act or for which the issuer is required to file reports pursuant to Section 15(d) of the Exchange Act for which there is an aggregate fail to deliver position for five consecutive settlement days at a registered clearing agency of 10,000 shares or more, and that is equal to at least 0.5% of the issuer's total shares outstanding, and is included on a list disseminated to its members by an SRO. See 17 CFR 242.203(c)(6) (West 2009).

26 See Letter from David T. Hirschmann, President & CEO, Ctr. For Capital Mkts.,Competitiveness, to Florence E. Harmon, Acting Sec'y, SEC (Dec. 16, 2008), available at http://www.sec.gov/comments/s7-30-08/s73008-50.pdf.

market.[27] Disclosure of short positions would simply be the corresponding analogue to these existing rules on the long side.

A. Public Disclosure of Short Positions

The Commission should expand and make permanent the temporary rules it adopted regarding disclosure of certain short interests so that (i) more information is required to be reported on Form SH; (ii) disclosed information is made available to the public; (iii) disclosure is required on a daily basis; and (iv) the entities required to report include all hedge funds, mutual funds, and other institutional investors.

Adopted as an interim final temporary rule by the Commission in October 2008, Rule 10a-3T requires institutional investment managers exercising discretion over accounts holding Section 13(f) securities with an aggregate fair market value of at least $100 million to file a Form SH on the last day of any calendar week following a week in which the institutional investment manager effected a short sale in any Section 13(f) security that is not an option. [28] Form SH requires disclosure of the number of securities sold short for each Section 13(f) security, except for short sales in options, and the opening short position, closing short position for that security during each calendar day of the prior week. [29] Initially implemented as an emergency order, Rule 10a-3T also required disclosure of the value of the securities sold short and the magnitude and time of the largest intraday short position, but the Commission removed these requirements after noting that some filers found the tracking of intraday short positions to be burdensome and that the value of the securities sold short could be easily calculated.[30] We believe that this disclosure should be restored in order to prevent manipulation of Form SH reporting with intraday trading strategies, and, in conjunction with the public disclosure requirements discussed below, provide complete and effective data to the marketplace.

Though initially Rule 10a-3T contemplated that Form SH would be publicly available on the EDGAR system, the Commission amended the rule several times, first to delay disclosure[31] and ultimately to provide that the information filed on Form SH remains nonpublic to the extent permitted by law. We believe that the rule should be modified so that the Form SH disclosure is made publicly available to the marketplace, and not just the Commission, and that disclosure be made on a more timely basis. Public disclosure will provide valuable information to the market; provide "advance notice" of market turbulence in response to abrupt price changes; and may act as a deterrent to the taking of aggressive short positions that would contribute to disruption of the marketplace.[32] To obtain these and other benefits of disclosure, short positions should be disclosed to the market as

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27 Institutional investment managers who exercise investment discretion over $100 million or more in Section 13(f) securities must report their holdings on Form 13F with the SEC. Section 13(f) securities are those described in Section 13d-1 of the Exchange Act and generally include exchange-traded or NASDAQ-quoted stocks, equity options and warrants, shares of closed-end investment companies and exchange-traded funds, and certain convertible debt securities. See 17 CFR 240.13f; 17 CFR 240 13d-1; Securities and Exchange Commission Division of Investment Management, Frequently Asked Questions about Form 13F (May 2005), available at: http://www.sec.gov/divisions/investment/13ffaq.htm.

28 Exchange Act Release No. 58785 (Oct. 15, 2008).

29 See Temporary Form SH, Weekly Report of Short Sales and Short Positions, available at http://www.sec.gov/about/forms/formsh.doc.

30 Exchange Act Release No. 58785 (Oct. 15, 2008).

31 See Exchange Act Release No. 58591A (Sept. 21, 2008).

32 Discussion Paper 09/1 from the Financial Services Authority on Short Selling (Feb. 2009) (on file with the FSA).

soon as possible. Many other G20 countries require real time or next trading day public disclosure of short sale data to the market.[33]

Finally, as adopted, Rule 10a-3T does not require that a Form SH be filed if the investment manager holds accounts with less than $100 million in Section 13(f) securities. Thus, an investment manager with less than $100 million in such securities could take a substantial short position in the securities of one or several issuers yet still entirely avoid the requirement to disclose on Form SH.

The rule should be modified to require disclosure by all institutional investors and other entities, such as hedge funds, that effect short sales and hold short positions in excess of de minimis thresholds.[34] Such investors should be required to file Form SH if their short position in a particular issuer exceeds 0.25% of the outstanding shares. [35] Filers of Form SH should also be required to report to the Commission on a next-day basis if they fail to deliver securities by the settlement date.[36]

B. Disclosure of Contracts, Arrangements, Understandings and Relationships by the Investor Regarding Shorted Securities

Form SH should also require disclosure of any contracts, arrangements, understandings or relationships by the institutional trader with regard to the shorted securities. The marketplace should have access to such information so that it can gain a more accurate understanding of the various activities that are influencing a particular stock's price.

This reporting requirement will help expose situations where some professional traders act in concert to drive down the price of a company's stock, while also enabling the company and the market to identify and respond to such tactics.

This kind of information disclosure has been in place and required for more than 40 years with regard to beneficial ownership of a security, and should be part of the disclosure required under Form SH with respect to short sales. Section 13(d)(1)(E) of the Williams Act provides a model for the type of information that should be reported, requiring of beneficial owners of a security: "information as to any contracts, arrangements, or understanding with any person with respect to any securities of the issuer...naming the persons with whom such contracts, arrangements, or understanding have been entered into, and giving the details thereof." These reporting requirements are intended to inform the marketplace about situations in which persons are acting in concert to effect a change in control of a company. In addition, this type of disclosure is already required on many forms, including Schedule 13D, Item 6; Schedule 14D-1, Item 7; and Schedule TO, Item 5. Similarly, disclosure of contracts, arrangements, understandings, and relationships in respect of short sales

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33 For example, the United Kingdom requires public disclosure of each new net short position of 0.25% or more in a financial sector company, as well as any change in such position of 0.1% or more, by 3:30 p.m. on the business day following the day on which the net short position was held. See Short Selling Instrument No. 5 (FAQs) version 2, Financial Services Authority (Jan. 19, 2009). See also FSA Discussion Paper, supra at § 5.44, proposing 0.50% as a threshold. Australia requires trading participants to report all short sales to the Australian Securities Exchange ("ASX") by 9 a.m. on the day following a short sale. On the same day, the ASX reports short sales to the market on an aggregate basis per security. See Regulation of Short Selling, Consultation Report, Technical Committee of the International Organization of Securities Commissions (March 2009) at 25-29, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD289.pdf .

34 Schedule 13D contains an analogous requirement in the context of beneficial ownership. See Rule 13d-1, 17 CFR § 240.13d-1 (West 2009).

35 Such disclosure triggers for short sale transactions and/or positions are common in other countries. See Regulation of Short Selling, Consultation Report, Technical Committee of the International Organization of Securities Commissions (March 2009) at 25-29. See also supra, note 33.

36 Memorandum from Edward D. Herlihy, Theodore A. Levine, and Carmen Woo, Esqs.,Wachtell, Lipton, Rosen & Katz, Bold SEC Action is Needed (Sept. 18, 2008) (on file with authors).

and short positions will allow market participants to correctly interpret the price signals sent by short sale activity and provide information critical to arriving at the correct valuation of the security.

C. Require Disclosure of CDS Purchases and Other Synthetic Investments that Simulate Short Positions in the Reference Entity

Some traders have been using the illiquid and opaque CDS market in connection with the use of short sales to manipulate share prices. The responsiveness of equity prices to changes in CDS spreads make the purchase of CDS a powerful, manipulative device.

CDS spreads function as immediate inputs to the market's perception of a company's liquidity and correspondingly into the market's valuation of a company's equity. Research into the empirical relationship between CDS and equity prices has found that weekly and daily stock returns are negatively associated with CDS spread changes,[37] and analysts at the major credit ratings agencies use CDS spreads to derive "market-implied ratings" of institutions.

By combining a short sale with the purchase of CDS, the traders can send a false signal into the marketplace as to the likelihood of credit default and, accordingly, cause a drop in the stock price. Such strategies are profitable, even if the investor is forced to take a loss on the CDS position.

A relatively small investment in an institution's CDS that increases the spread can start rumors of default or a ratings downgrade and immediately sink stock prices. By potentially causing the company's cost of capital to increase and withdrawal by the company's counterparties,[38] the initial manipulative CDS purchase effectively becomes a "self-fulfilling prophecy" that inevitably benefits those with short positions in the company's equity.

To help prevent manipulation, we urge the Commission to require net short sellers of a stock to disclose the timing and amount of any long position in the referenced entity's CDS, as well as the timing and type of any other derivative position that is equivalent to, or simulates, a short position in the referenced entity's stock. Such disclosure would result in greater transparency and clarity in the market as to the true intentions of these investors, and would counteract the false signal being sent to the marketplace regarding the likelihood of credit default for the company by purchasers of CDS who also hold short positions in the company.

The Commission is authorized under the Commodity Futures Modernization Act of 2000 (the "CFMA") to take enforcement action against fraud, manipulation, and insider trading abuses with respect to security-based, but not other, swap agreements. [39] While the Commission is prohibited from, among other things, requiring registration or certain public filings of swaps under the CFMA, we believe that the proposed disclosure regarding these CDS/short positions falls within the Commission's enforcement authority.

If the Commission is unclear whether it currently possesses the authority to impose any of these reforms, we recommend that the Commission seek explicit Congressional action enabling it to address these manipulative and abusive practices afflicting our markets. [40] We would urge any such

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37 Nader Naifar & Faith Abid, The Determinants of Credit Default Swap Rates: An Explanatory Study, 9 Int'l J. Theoretical and Applied Fin. 1 (2006).

38 See id. and George Soros, One Way to Stop Bear Raids, Wall St. J,. Mar. 23, 2009.

39 15 U.S.C. § 78j(b) (West 2009).

40 The Treasury recently proposed reforms of the over-the-counter ("OTC") derivatives market, including amendments to the Commodity Exchange Act and securities laws to (i) authorize the Commodity Futures Trading Commission (the "CFTC") and the Commission to impose recordkeeping and reporting requirements on OTC derivatives and (ii) ensure that these regulators have "clear, unimpeded

legislation to be carefully considered and drafted to avoid further regulatory ambiguity and uncertainty regarding the authority of the Commission to regulate swap agreements. Action by the Commission to ensure that it can implement these suggested reforms will help protect investors who are manipulated into relying on false indicators, as well as the underlying businesses which are being targeted by these abusive practices.

Thank you for the opportunity to comment on this proposal.

Sincerely,

Michael R. McAlevey
Vice President and Chief Corporate,
Securities & Finance Counsel

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authority to police fraud, market manipulation, and other market abuses involving all OTC derivatives." Additionally, Sens. Carl Levin and Susan Collins recently introduced legislation, the Authorizing the Regulation of Swaps Act (the "Levin-Collins Bill"), which contemplates seven different federal financial regulators with varying degrees of authority to regulate swap agreements and requires that they cooperate and consult with each other in such regulation. See Letter from Timothy F. Geithner, Sec'y of the U.S. Dep't of the Treasury, to the Hon. Harry Reid, U. S. Senate (May 13, 2009), available at http://www.financialstability.gov/docs/OTCletter.pdf; see also The Authorizing the Regulation of Swaps Act, S. 961, 111th Cong. (2009).