Vanguard®
Valley Forge, PA 19482-2600

610-669-1000
www.vanguard.com

June 19, 2009

Submitted electronically
Elizabeth M. Murphy, Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-1090

RE: Proposed Amendments to Regulation SHO
File Number S7-08-09

Dear Ms. Murphy:

Vanguard[1] appreciates the opportunity to comment on the various proposals of the Securities and Exchange Commission ("Commission") to regulate short selling.[2] We agree with the Commission that it is important for investors to have confidence in our financial markets. Vanguard prides itself on doing what is in the best interest of Vanguard fund shareholders, who comprise millions of individual and institutional investors including families, retirees, employee benefit plans, and others. We believe investment plans should focus on long-term financial goals and that minimizing the costs of investing is vital for long-term investment success. Our focus on long-term investors informs our comments on the Commission's various proposals to regulate short selling.

Restricting the ability to effect short sales would not have a significant direct impact on Vanguard's day-to-day operations. Nevertheless, we believe certain restrictions on short selling could have a significant deleterious impact on market efficiency, negatively affecting our broad investor population. Thus, we share the Commission's view that any such restrictions must be supported by a cost/benefit analysis based on empirical data.

Short Selling Generally

As the Commission recognizes, short selling plays a legitimate and important role in today's markets by providing liquidity and enhancing price discovery. Restrictions on short selling have the undesirable effect of decreasing liquidity, skewing prices and potentially increasing volatility. These ramifications come at a real cost to all investors – not just short sellers. For example, when liquidity decreases, spreads widen and investors

[1] The Vanguard Group, Inc. ("Vanguard") offers more than 150 U.S. mutual funds with total assets of approximately $1.1 trillion. We serve approximately 23 million shareholder accounts.

[2] *Amendments to Regulation SHO*, Securities Exchange Act Release No. 59748 (April 10, 2009) ("*Reg SHO Release*").

accordingly incur higher transaction costs. For this reason, it is important to draw a distinction between short selling practices that benefit the markets in the ways described above and manipulative short selling practices that disrupt the markets and harm market participants. "Naked" short selling and "rumor mongering" are two examples of manipulative short selling. These methods of conducting "bear raids" through short selling are already illegal. In any approach to new regulation of short selling, care should be taken to be sure that the regulation of undesirable short selling practices does not collaterally impact legitimate and beneficial trading practices and thereby make the markets worse, rather than better, for investors.

Investor Confidence vs. Investor Protection

"Investor confidence" has been mentioned repeatedly as the primary benefit of adopting short sale restrictions. Vanguard believes it is important to distinguish between "investor confidence" and "investor protection." As illustrated in the following paragraph, regulation that generates greater confidence without true protection may do more harm than good.

It is widely believed that reinstatement of short sale price test restrictions will prevent a recurrence of the recent extreme market volatility.[2] Although popular, this belief is not supported by any empirical data. Rather, the extreme market volatility was created by the economic fundamentals and events of the time. Even if restricting short selling increases "investor confidence" over the short term and accelerates investors' return to the equity markets, that investor confidence will be misplaced. The evidence to date does not suggest that such restrictions increase liquidity, curb bear raids or decrease volatility. In the event of another significant market decline despite the existence of new short sale restriction, investor confidence in the markets could erode even further – the opposite result of what the Commission intends.

The Commission's stated mission is "to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation." If the Commission can identify the ways in which short sale restrictions will support these goals, further regulation may be appropriate. If not, then the proposals should not be enacted. In fact, an ill conceived short sale restriction could undermine these goals.

Short Sale Proposals

If there is a sound evidentiary basis for regulation, Vanguard favors measures that minimize the impact on liquidity and price discovery. Of the proposals set forth in the Commission's release, we believe a security-specific Circuit Breaker that triggers a Modified Uptick Rule (bid test) in the particular security is the alternative that would have the least deleterious impact on the market efficiencies created by short selling. To

[2] See *Reg SHO Release* at FN 56.

the extent the proposed regulation is designed to prevent bear raids of particular companies through short selling, we believe a security-specific Circuit Breaker approach is better tailored to address this form of wrongful conduct than a market-wide approach.[3] Likewise, the imposition of a Modified Uptick Rule when the Circuit Breaker is triggered is preferable to an outright halt because it permits the continuation of legitimate short selling (and the associated market efficiencies).

Vanguard also believes that registered market makers should be exempt from any of the proposed short sale restrictions. Market makers play a crucial role in providing liquidity to the market, and they utilize short selling to accomplish this function. The short selling activity of market makers is not tied to the perceived harm behind the short sale proposals. In particular, there is no evidence that market makers play a role in facilitating bear raids through short selling. Accordingly, we believe market makers should be exempt from any of the short sale restrictions the Commission may adopt.

Other Issues for the Commission's Consideration

Vanguard commends the Commission's recent efforts designed to curb naked short selling. We support Interim Final Temporary Rule 204T's enhanced delivery requirements for both long and short sales, and we support making the rule permanent. Rule 204T has dramatically reduced the number of securities on Reg SHO's threshold lists.

Vanguard also supports the Commission's recent efforts requiring disclosure of short positions of institutional investment managers to the Commission. However, we believe that the disclosure of this information to the Commission should remain confidential to protect proprietary trading strategies. Limiting the disclosure of short positions to the Commission strikes the appropriate balance. It provides the Commission with the information it needs to detect and prevent abuse and manipulation, while protecting the legitimate interests of investors in keeping their trading strategies confidential.

Finally, Vanguard shares the Commission's concerns about the ability to create synthetic short sales through over the counter derivatives. More importantly, we are concerned that the price test restrictions set forth in the proposal, if adopted, could actually result in an increased use of synthetic short sales. Because of this, Vanguard believes the SEC should examine potential manipulative conduct in this area. For instance, Vanguard believes the Commission should investigate the practice of purchasing protection through credit default swaps and at the same time shorting a company's stock. It appears that the former of these two strategies may allow market participants to negatively impact a company's financial situation and the latter allows them to profit from the downward impact they created. Vanguard believes such conduct may be manipulative and a further examination of these practices is warranted.

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Vanguard appreciates the Commission's willingness to consider all options (including the option of taking no action) and its focus on seeking a solution supported by empirical data. Please do not hesitate to contact me or John Bisordi, Senior Counsel at (610) 669-2624 if you have any questions or require additional information.

Sincerely,

/s/ Gus Sauter

George U. Sauter
Managing Director and Chief Investment Officer
The Vanguard Group, Inc.

cc: The Honorable Mary L. Schapiro
The Honorable Kathleen L. Casey
The Honorable Elisse B. Walter
The Honorable Luis A. Aguilar
The Honorable Troy A. Paredes

James Brigagliano, Acting Co-Director
Dan Gallagher, Acting Co-Director
Division of Trading and Markets
U.S. Securities and Exchange Commission