



GLOBAL ELECTRONIC TRADING COMPANY

June 19, 2009

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

Re: Amendments to Regulation SHO Release No. 34-59748, File No. S7-08-09

Dear Ms. Murphy:

I. Introduction

Global Electronic Trading Company ("GETCO")¹ appreciates the opportunity to comment on the above captioned short selling proposal to amend Regulation SHO ("proposals" or "price tests"). GETCO recognizes that the Securities and Exchange Commission ("SEC" or "Commission") issued these proposals in an effort to help stabilize the U.S. equity and options markets in a period of extraordinary volatility and uncertainty. We commend the SEC for allowing sufficient time for market participants to comment on these important market structure proposals. Given the history of short selling regulation, the dramatic market structure changes over the last decade in how equities and options trade, and the long term effect these proposals will have on the markets, it is important that the Commission carefully consider what additional short-selling restrictions, if any, to implement.

GETCO's comments will be discussed in detail below and generally relate to the following positions: (1) GETCO opposes the re-implementation of any short-selling price tests; (2) if the SEC deems it necessary to adopt one of the proposals, GETCO favors a circuit breaker combined with a modified uptick rule approach (i.e., bid test) or a short sale trading halt; and (3) any short-sale price test that the Commission adopts, should contain an exception for equities and options market makers that are engaged in bona-fide market making activity.

II. Short Sale Price Tests are Ineffective Investor Protection Tools

¹ GETCO, with offices in Chicago, New York, London and Singapore is a privately-held, electronic trading firm that provides liquidity to exchanges and Alternative Trading Systems ("ATs") in the US, Europe and Asia. GETCO, an early entrant in electronic trading, is an electronic market maker on various exchanges and ATs. GETCO is a registered market maker on various equities and options exchanges including the BATS Exchange, Chicago Board Options Exchange, Nasdaq Exchange, and NYSE Arca.

GETCO recognizes that the Commission is attempting to restore investor confidence with the price test proposals. However, as the Commission has acknowledged, the short-sale price tests have been analyzed more thoroughly than almost any other issue in the SEC's history. After a multi-year examination on the effectiveness of price tests, the Commission determined in 2007 to eliminate them because empirical evidence produced by the SEC's Office of Economic Analysis and outside researchers concluded that short sale price tests were ineffective and unnecessary regulations.² The Commission should not now back away from its deliberative and well-reasoned assessment.

Accordingly, GETCO opposes the re-implementation of any short-sale price tests. While often unfairly maligned as "manipulative," short selling is a lawful and important component of efficient markets. Legitimate short selling activity provides a reliable source of market liquidity and price discovery. It is critical for the SEC and the SROs to distinguish between this legitimate short selling activity, and such short-selling practices as manipulative "naked shorting."³ GETCO believes that if the SEC now adopts any of the price tests contained in the rule proposal, the Commission would place artificial and ineffective restrictions on a lawful trading practice that has no relation to manipulative naked short selling or other manipulative activities.

GETCO understands that the Commission may be criticized if it does not re-implement a price test. Such criticism, however, will not be based on any empirical market structure research or investor protection principles. Proponents of a price test rule have provided no evidence that re-implementation will protect investors. Additionally, contending that a price test rule will not harm the markets is an unpersuasive argument for re-adopting one, particularly when weighed against the compelling evidence⁴ that a price test will make today's equity and options markets less efficient, less liquid and more costly. GETCO notes that researchers have found that placing material restraints on market participant's ability to short sell—which a price test would do—could lead to a degradation in market quality.⁵

GETCO also believes it is important to note that a price test may inhibit efficient price discovery. In general, a price test limits the pool of participants who can respond to negative information in

² See Exchange Act Release No. 34-55970 (June 28, 2007).

³ Manipulative "naked shorting" undermines investor confidence and is inapposite for healthy, efficient markets. As a result, the Commission has appropriately taken significant steps to curb this practice. In approving amendments to section 204T to Regulation SHO as well as adopting rule 10b-21 the Commission has dramatically reduced fails to deliver, which is associated with manipulative naked shorting. Accordingly, firms risk being subjected to sanctions—including fraud charges—if they engage in manipulative conduct associated with naked short-selling (i.e., if they have no intention of borrowing the stock that they have shorted and will consequently incur a fail to deliver).

⁴ See generally, Exchange Act Release No. 34-55970 (June 28, 2007).

⁵ For example, a recent study on the effect of the 2008 short selling ban found that: "stocks subject to the ban suffered a severe degradation in market quality as measured by spreads, price impacts and intra-day volatility." Boehmer, Ekkehart, Jones, Charles M. and Zhang, Xiaoyan. 2009. "Shackling Short Sellers: The 2008 Shorting Ban." Social Science Research Network <http://papers.ssrn.com/sol3/papers.cfm?abstractid=1412844>

a particular security to those that already own the stock. As such, passive investors that are not actively tracking a company's prospects, but may own large quantities of its stock in a retirement or investment account rely on an orderly, well-functioning market to achieve fair risk-adjusted returns. Material constraints on short selling harm the price discovery process; even though information is available that would otherwise cause the price of a stock to drop, without short sellers fully contributing to price discovery, the stock is not able to get to its equilibrium price efficiently. The market will know prices are inflated, and consequently it will be difficult to provide fair prices to all buyers and sellers.

GETCO urges the Commission to reject the re-implementation of any price test by relying on its own voluminous and convincing record that short-sale price test restrictions are not useful investor protection tools.

III. Price Test Proposals

If the Commission adopts any price test, GETCO believes the best alternatives are a circuit breaker--currently proposed at ten percent (10%) below the last sale price reported to the consolidated tape during regular trading hours on the prior day--combined with either the modified up-tick rule (bid test) or a short sale trading halt. GETCO agrees with the Commission that the modified uptick rule is a better approach than the uptick rule because the bid is a more accurate reflection of the current state of the market.

The Commission also sought comment on how the circuit breaker should be calculated (i.e., from the close of the previous day or after the opening price). GETCO believes that calculating the percentage for the circuit breaker should begin after the opening price for that trading day. For example, if security XYZ closed at \$25.00 and the following day the opening price was \$21.00, the circuit breaker should not be effected until the price of XYZ reaches ten percent below \$21.00 (\$18.90). As the Commission noted in the proposing release, the purpose of the circuit breaker is to prevent short selling from exacerbating severe intra-day price moves. If a security drops severely in price overnight (or in the pre-open market) and the opening price is sharply lower, this is the result of material news related to the fundamental valuation of the company, sector, or index in question and not from any intra-day short-selling activity. In other words, short selling should not be restricted merely because the valuation of a security has changed, even if the valuation is drastically lower than the prior day's closing price.

IV. Any Price Test Restrictions Should Contain a Market Maker Exception

If the Commission determines that the reimplementation of a price test is necessary to help restore investor confidence, then GETCO believes that the Commission should allow for an exception for equities and options bona-fide market makers, regardless of the price test implemented. At the outset it is important to understand how market makers typically operate. Market makers perform a vital function in our market place by maintaining two-sided markets, i.e., providing both bids and offers. This function allows for investors to more easily access liquidity, improves price discovery and reduces volatility by providing a steady stream of demand or supply. Market makers do not have a directional bias on whether a stock price goes up or down. Direction neutrality is inherent in the very nature of market making and as such there is no incentive to establish short positions to drive the price of a stock down or engage in "bear raids" during the course of bona-fide market making (i.e., intentionally force down the price of a stock with rumors in order to profit from a

short position). Market makers typically attempt to end each trading day with as little risk or position as possible in a given security, i.e. flat.

A. The Reasons for a Market Maker Exception

In the Proposing Release, the Commission did not recommend an all-encompassing exception for market makers, regardless of the price test that may be adopted. Rather, the Commission proposed a limited exception for market-makers under the proposed uptick rule and corresponding circuit breaker/uptick rule proposal, as well as a full exception for bona-fide market makers if the Commission were to adopt a circuit-breaker/short sale halt price test. While the Commission did not propose a market maker exception for the modified uptick rule or circuit breaker/modified uptick rule, the Commission requested comments on whether a general market maker exception is warranted in this context. In particular, the Commission asked for comments “on the importance of a market maker provision in the context of a market maker’s role in providing liquidity, including the extent to which market makers would need to sell short at or below the current national best bid in their market making capacity.”⁶ GETCO believes that if the Commission adopts a price test then a market maker exception should be included in the rule, regardless of the test adopted. The reasons are described below.

First, if a modified uptick rule is adopted, GETCO recognizes that a market maker typically should not need an exception because the market maker will be able to sell short on the offer when providing liquidity. However, market makers such as GETCO often employ market making strategies that sometimes include removing liquidity on the bid as part of the overall strategy, which may include short selling. Such strategies benefit investors because market makers are able to provide tighter spreads and more liquidity resulting from the market maker’s ability to seamlessly post bids and offers without the constraints of a price test. By having to adhere to a price test, it becomes more difficult for market makers to perform their core function of efficiently making two-sided markets, which may ultimately result in increased costs for investors because the market maker must account for this inefficiency with a wider bid-ask spread.

Second, it is important that options market makers have the immediate ability to sell short--potentially on a down bid--to remove liquidity as part of a market making strategy. A price test without a market maker exception will increase frictions on the options market maker’s ability to hedge and will increase their costs. Such a limitation will reduce quote competition and ultimately hurt all investors in the form of wider spreads and less liquidity.

Third, barriers to entry for new market makers will likely increase. To ensure compliance with a more onerous price test rule and still perform bona-fide market making activity, market makers may be forced to construct hedged portfolios by buying baskets of securities that are hedged with futures so that they can sell stocks long rather than short. Costs of such a portfolio (tied up capital, slippage) will inevitably be high and create a barrier to entry for future competitors, cementing a dominant position for today’s successful market makers. Historically, reduced competition has increased costs that will be passed on to investors in the form of wider bid ask spreads.

⁶ Exchange Act Release No. 34-59748 (April 10, 2009).

Fourth, market quality may deteriorate. Firms that choose to employ a long-stock portfolio in order to comply with any short sale regulations will most likely focus on high liquidity/high opportunity stocks to compensate for the high cost associated with maintaining a fully-hedged portfolio. Therefore, the market quality of trading in less-liquid stocks will likely decrease because fewer market makers will compete to provide liquidity.

Finally, volatility may increase. In the course of providing liquidity, market makers dampen volatility by holding themselves out to buy and sell on a regular and continuous basis. Market makers typically respond to the demand characteristics of the market by adjusting the supply price and quantity. For example, market makers often provide liquidity on the opposite side of price moves, which helps reduce volatility.

A market maker exception is warranted because the market is more likely to rise after a decline if a market maker is able to efficiently post bids and offers (including offers to sell short) without the restrictions of a price test. Liquidity on the offer is important to restart upward price movements and much of the liquidity on the offer will be provided by market makers who may be short. In sum, GETCO believes that in order for investor confidence in the markets to be restored, it is important to allow market makers to provide short liquidity.

B. Market Maker Exception Should Only Apply for Bona-Fide Market Makers

GETCO recognizes that the Commission needs to carefully consider whether there are adequate regulatory reasons for providing an exception to any price test for one class of market participants--in this case market makers. GETCO believes, however, that market-makers engaged in bona-fide market making should be excepted from any short sale price test restriction, regardless of the proposal the Commission may adopt.

The Commission has routinely recognized the importance of excepting bona-fide market makers from short sale restrictions.⁷ The Commission has expressly recognized that market makers may short-sell in a declining market and still be engaged in bona-fide market making. In October 2008, the SEC provided useful guidance on what constitutes bona-fide market making when it adopted amendments to regulation SHO and provided that:

Although determining whether or not a market maker is engaged in bona-fide market making would depend on the facts and circumstances of the particular activity, factors that indicate a market maker is engaged in bona-fide market making activities may include, for example, whether the market maker incurs any

⁷ Regulation SHO contains numerous exceptions for bona-fide market making activity, the most notable being the "Locate Exception." The Commission has stated: "The rule includes certain exceptions from the locate requirement, which mitigate many associated cost burdens. The rule provides an exception for bona-fide market making. This exception covers short sales executed by market makers, including specialists and options market makers, in connection with bona-fide market making activities. Excepting bona-fide market making activity from the locate requirement will benefit investors and the market by preserving necessary market liquidity." See Exchange Act Release No. 34-50103(July 28, 2004).

economic or market risk with respect to the securities (e.g., by putting their own capital at risk to provide continuous two-sided quotes in markets)....

A pattern of trading that includes both purchases and sales in roughly comparable amounts to provide liquidity to customers or other broker-dealers would generally be an indication that a market maker is engaged in bona-fide market making activity. *Thus, even selling short into a declining market may be an indication that a market maker is engaged in bona-fide market making activity.* Continuous quotations that are at or near the market on both sides and that are communicated and represented in a way that makes them widely accessible to investors and other broker-dealers are also an indication that a market maker is engaged in bona-fide market making activity. However, as noted above, a market maker must hold itself out as being willing to buy and sell a security for its own account on a regular or continuous basis.⁸

GETCO considers the factors articulated above to be appropriate and meaningful benchmarks in the context of the Commission's "facts and circumstances" analysis for determining whether or not a market maker is engaged in bona-fide market making for purposes of being excepted from a short sale price test. Moreover, GETCO would also recommend that the exchanges consider adopting standards that would be consistent with the SEC's guidance and create more stringent market maker requirements for trading on their markets.⁹ Under several exchange's current rules, market making is generally defined as a broker-dealer that is willing to buy and sell securities on a regular or continuous basis. Many of the requirements associated with meeting this broad and general definition are easily met and impose no true affirmative quoting or liquidity providing obligations on market makers.

GETCO recommends that a firm would be deemed a bona-fide market maker by meeting more stringent quoting and trading obligations in accordance with the SEC's previously articulated guidance. For example, market makers, in providing two-sided quotations, must routinely put their capital at risk as opposed to only executing on a riskless principal basis. Market making firms must also be able to provide evidence, through their books and records, that they meet their market making obligations.

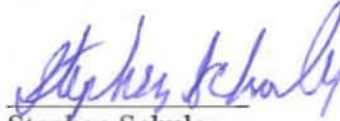
In closing, GETCO believes that requiring market makers to adhere to more rigorous bona-fide market making standards is an effective way for the Commission to balance the competing goals of preventing any market maker exception "loophole," while still preserving the ability of true bona-fide market makers to efficiently carry out their quoting and trading obligations because they are not subjected to a price test.

⁸ See Exchange Act Release No. 34-58775 (October 14, 2008).

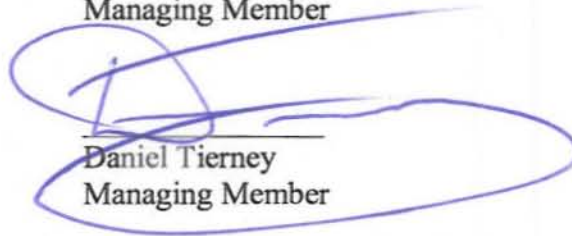
⁹ GETCO notes that NASD's old rule 3350--when originally approved by the Commission--contained a market maker exception that required bona-fide market makers to meet enhanced quoting obligations in order to qualify for the exception. See Exchange Act Release No. 34-34277 59 FR 34885, 34886-34887 (June 29, 1994).

GETCO appreciates the opportunity to submit these comments. Please do not hesitate to contact us at (312) 242-4600 if you have any questions regarding any of the comments provided in this letter.

Sincerely,

A handwritten signature in blue ink, appearing to read "Stephen Schuler", written over a horizontal line.

Stephen Schuler
Managing Member

A handwritten signature in blue ink, appearing to read "Daniel Tierney", written over a horizontal line. The signature is enclosed within a large, loopy blue oval.

Daniel Tierney
Managing Member