NATIONAL ASSOCIATION OF
REAL ESTATE INVESTMENT TRUSTS®

September 21, 2009

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

Re: Amendments to Regulation SHO (File No. S7-08-09)

Dear Ms. Murphy:

The National Association of Real Estate Investment Trusts® ("NAREIT") appreciates the opportunity to comment on the alternative price test with respect to previously proposed amendments to Rules 200(g) and 201 of Regulation SHO [17 CFR 242.200(g) and 17 CFR 242.201] under the Securities Exchange Act of 1934. NAREIT is the worldwide representative voice for REITs and publicly traded real estate companies with an interest in U.S. real estate and capital markets. NAREIT's members are REITs and other businesses throughout the world that own, operate and finance income-producing real estate, as well as those firms and individuals who advise, study and service those businesses.

On April 10, 2009, the Commission published Proposed Rules that would amend Regulation SHO under the Securities Exchange Act of 1934 to restrict short selling under certain conditions with the intent of curbing abusive short selling and related trading practices. In our submission, dated June 19, 2009, we expressed support for the Commission's proposal, and we urged the Commission to adopt as quickly as possible one or more of the proposed short sale price test restrictions or proposed circuit breaker rules individually or in some effective combination.

On August 17, 2009, the Commission re-opened the comment period with respect to the Proposed Rules, seeking additional feedback regarding an alternative price test that would allow short selling only at a price above the current national best bid (the "alternative uptick rule"). We appreciate the opportunity to affirm our earlier support for the Proposed Rules, including the alternative uptick rule, and we again urge the Commission to adopt as quickly as possible one or more of the proposed short sale price test restrictions or proposed circuit breaker rules, including the alternative uptick rule, individually or in some effective combination.

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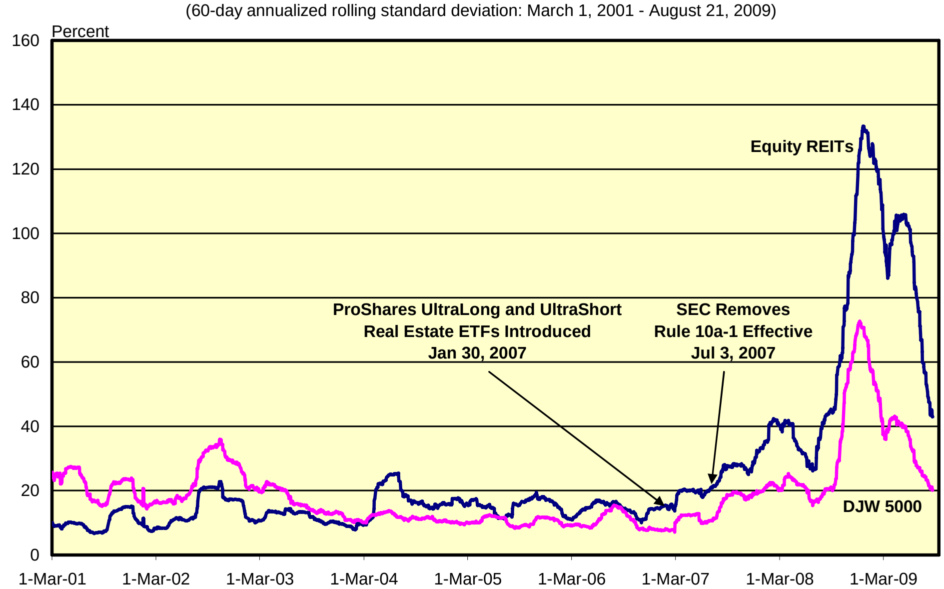
**I. Market Volatility**

Following the removal of Rule 10a-1 and all other short sale price test restrictions effective July 3, 2007, the volatility of equity share prices increased nearly 700 percent through December 2008.[1] As shown in Exhibit 1, the volatility of the Dow Jones Wilshire 5000 Index of daily share price returns increased from 10.74 percent on July 3, 2007 to 72.60 percent on December 8, 2008. In like manner, the volatility of the FTSE NAREIT Equity REIT Index of daily share price returns increased from 20.90 percent on July 3, 2007 to 133.36 percent on December 19, 2008. Although volatility has eased in recent months, it remains at elevated levels and could again move sharply higher.

A number of factors likely have contributed to the significant increase in market volatility. However, some have suggested that one of those factors has been abusive short selling practices driven by objectives beyond the need for market liquidity and price discovery. The higher level of investor uncertainty concomitant with higher market volatility clearly has eroded investor confidence in the efficiency and efficacy of public securities markets, with deleterious effects for businesses, employment levels, economic growth, retirement security and systemic risk in financial markets.

**Exhibit 1**
**Daily Price Return Volatility**
FTSE NAREIT Equity REIT Index and Dow Jones Wilshire 5000 Index
(60-day annualized rolling standard deviation: March 1, 2001 - August 21, 2009)




[1] Volatility is measured as the 60-day annualized rolling standard deviation of daily share price returns.

**II. Market Making in Derivatives**

With respect to proposed short sale price test restrictions, the Commission noted that provisions contained in paragraph (d) of proposed Rule 201 would parallel exceptions to former Rule 10a-1 and exemptive relief granted pursuant to that rule. The Commission also noted the apparent absence "of any reason that the rationales underlying these exceptions and exemptions from former Rule 10a-1 would not still hold true today … [nor that] including provisions that would parallel these exceptions and exemptions to former Rule 10a-1 would undermine the Commission's stated goals for proposing short sale price test restrictions."

With respect to proposed circuit breaker price test rules, the Commission noted that "the proposed circuit breaker halt rule would include exceptions substantially identical to exceptions that were included in the Short Sale Ban Emergency Order, as amended by the Commission on September 21, 2008."[2] The Commission noted further its belief that "the proposed circuit breaker halt rule should include exceptions that mirror certain of the exceptions in the Short Sale Ban because the proposed rule shares the same goal of prohibiting short selling that might exacerbate a price decline during a period of sudden and excessive price declines, while being designed to maintain functions that, for example, would be necessary to help provide adequate liquidity."

Of particular note, the Short Sale Ban included an exception that "applied to all market makers, including over-the-counter market makers, and to bona fide market making and hedging activity related directly to bona fide market making in exchange traded funds and exchange traded notes of which securities included in the Short Sale Ban were a component." In its proposal, the Commission repeated that the purpose of the exception "was to permit market makers to continue to provide liquidity to the markets" and stated further its belief that such an exception "would be appropriate for the proposed circuit breaker halt rule."

With respect to exchange-traded funds (ETFs), we caution the Commission to consider carefully the exemptive relief available for a limited class of these funds. In particular, we urge the Commission to distinguish between traditional long, un-leveraged ETFs and other more recent products commonly referred to as leveraged and inverse ETFs. Traditional ETFs provide investors a simple and low-cost platform for achieving <u>long-term</u> investment returns from broadly diversified indexes of equity or fixed income securities and have proven themselves as effective and suitable investments for achieving those objectives. However, leveraged and inverse ETFs provide only daily return benefits in avoidance of various margin requirements.

**III. Leveraged and Inverse ETFs**

Leveraged and inverse ETFs provide leveraged long or short exposure to the <u>daily</u> investment returns of various indexes of equity and fixed income securities, including certain REIT indexes. First introduced in 2006, these funds have "leverage" explicitly embedded as part of their product design. These products now include leveraged, inverse and leveraged inverse ETFs.

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[2] See Short Sale Ban Emergency Order, 73 FR 55169-02 (September 24, 2008) and September 21, 2008 Amendment, 73 FR 55556-01 (September 25, 2008).

According to a Barclays Global Investors (BGI) analysis, there are more than 100 leveraged and inverse ETFs in the U.S. with assets under management of about $22 billion as of January 2009.[3]

Several factors help to explain the popularity of leveraged and inverse ETFs. First, these funds offer market participants structured products to take market positions consistent with their expectations for the performance of various equity and fixed income indexes. Second, investors can obtain leveraged exposure to certain sectors and markets without using more complicated and perhaps costly derivatives such as swaps, options, futures or trading on margin. Third, individual investors reportedly are attracted by the convenience and limited liability of such products and use them—often mistakenly—to take longer-term leveraged positions or to hedge their portfolios.

Leveraged and inverse ETFs may not be either suitable or well understood by some investors, particularly individual investors. According to the BGI analysis, a leveraged or inverse ETF replicates a multiple of the underlying index return on a daily basis, but the gross return of such funds over a finite time period can be shown to have an embedded path-dependent option on the underlying index that, under certain conditions, can lead to value destruction. For example, the Dow Jones U.S. Real Estate Index posted a return of -40 percent in 2008, and consistent with this performance, the ProShares Ultra Real Estate ETF (designed to provide two times the index return) recorded a return of -81 percent. However, the ProShares UltraShort Real Estate ETF (designed to provide two times the inverse index return) registered a return of -50 percent. Likewise, in the first quarter of 2009, the Dow Jones U.S. Real Estate Index posted a return of -30 percent, while the ProShares Ultra Real Estate Index posted a return of -62 percent, but the ProShares UltraShort Real Estate Index posted a return of only 4 percent.

Owing in part to such performance, the BGI analysis concludes that "leveraged and inverse ETFs are not suitable for buy-and-hold investors" because their long-run returns under certain circumstances can be significantly less than that of the appropriately levered underlying index. The authors also note, "Unlike traditional ETFs, leveraged and inverse ETFs can be viewed as pre-packaged margin products, albeit without any restrictions on margin eligibility."

The BGI analysis also concludes that the daily re-balancing of the funds may exacerbate "the volatility of the underlying index and the securities comprising the index." In particular, a Wall Street Journal story late last year noted, "As the market grew more volatile in September, Wall Street proprietary trading desks began piling onto the back of the trade knowing that the end-of-day ETF-related buying or selling was on its way. If the market was falling, they would buy a short ETF and short the stocks or the market some other way. If the market was rallying, they would buy a bull fund and go long."[4]

When considering exemptions to proposed short sale price test restrictions or proposed circuit breaker rules in the future, NAREIT urges the Commission not to extend such exemptions to a

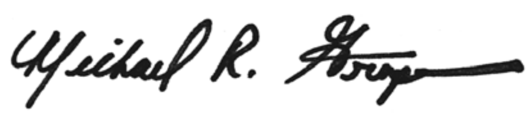
[3] Cheng, M., and A. Madhavan, "The Dynamics of Leveraged and Inverse Exchange-Traded Funds," Barclays Global Investors, May 9, 2009.
[4] Lauricella, T., S. Pulliam, and D. Gullapalli, "Are ETFs Driving Late-Day Turns? Leveraged Vehicles Seen Magnifying Other Bets; Last-Hour Volume Surge," Wall Street Journal, December 15, 2008, C1.

limited class of derivative products—leveraged, inverse and leveraged inverse ETFs—without carefully considering whether it is necessary and appropriate to do so. For example, while it may be appropriate (as was the case under former Rule 10a-1) to exempt traditional ETFs from short sale price limitations, as their prices are so closely linked to the price of their components that short sales of such ETFs could not be used to manipulate them downward, there is no evidence that this is true for leveraged, inverse and leveraged inverse ETFs. Similarly, in keeping with the need to provide appropriate levels of market liquidity and effective price discovery, NAREIT supports extending such exemptions to include traditional long, un-leveraged ETFs. In addition, it may be appropriate for the Commission to consider separately from the proposed amendments to Regulation SHO whether such leveraged investment products are suitable investments without restrictions on margin eligibility.

The pricing of publicly traded securities always will be affected by economic fundamentals, financial market conditions and corporate performance, as well as by the emotional tides of investors. New investment products and appreciable shifts in the rebalancing of institutional portfolios also will play a continuing role. However, new products, rules and regulations that lead to investor confusion, unsuitable investment products or market manipulation may also result in less efficient markets and inappropriately elevated levels of risk. In such cases, remedies may be appropriate.

We appreciate the opportunity to comment with respect to the proposed amendments to Regulation SHO, and we would welcome the opportunity to meet with appropriate Securities and Exchange Commission staff to review and discuss our comments in greater detail. Should you have any questions or require further information pertaining to our comments, please contact me at mgrupe@nareit.com, or directly at 202-739-9409.

Respectfully submitted,



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