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

RE: File No. S7-08-09  
Release Number 34-60509  
Proposed Amendments to Regulation SHO

Dear Ms. Murphy:

The Security Traders Association of New York, Inc. (“STANY”) respectfully submits this letter as a supplemental response to the Securities and Exchange Commission’s (the “SEC” or the “Commission”) request for comments on an alternative price test in proposed amendments to Regulation SHO under the Securities Exchange Act of 1934 (the “Exchange Act”).

The Security Traders Association of New York is the voice of the trader in the New York metropolitan area. STANY represents approximately 1,200 individuals, all engaged in the buying, selling and trading of securities. As such, we are uniquely qualified to discuss rules and regulations affecting the purchase and sale of securities. STANY is the largest affiliate of the Security Traders Association (STA). STA is a multinational professional trade organization that works to improve the ethics, business standards and working environments of its members. Neither STA, nor STANY, represent a single business or business model, but rather provide a forum for traders representing institutions, broker-dealers, ECNs, ATSS and floor brokers to share their unique perspectives on issues facing the securities markets. Our members work together to promote their shared interest in efficient, liquid markets, as well as their concern for investor protection. We believe that strong and efficient markets require an appropriate balance between effective regulation and innovation and competition.

STANY thanks the Commission for providing the opportunity for interested parties to present their opinions on an alternative price test that would allow short selling only at a price above the current national best bid (“NBB”), unless an applicable exception applies (“alternative uptick rule”).

As we mentioned in our comment letter dated June 19, 2009 (which we incorporate herein by reference), opinions of our members differ as to the merits of the various alternative approaches to short sale regulation advanced by the Commission. Despite the difference of opinion on the best regulatory solution to curb potential abuses of short selling, the majority of our members support short selling as a legitimate investment activity that serves as a key mechanism for generating market liquidity, securing price discovery, and fostering corporate accountability and responsibility. We believe that the benefits of short selling on the market and for investors outweigh the detriments, provided that manipulative practices are deterred and regulations to curb those practices are enforced.

As the Commission aptly noted, “Market liquidity is often provided through short selling by market professionals.... Short sales effected in the market add to the selling interest of stock available to purchasers and

reduce the risk that the price paid by investors is artificially high because of temporary imbalance between buying and selling interests.”<sup>1</sup>

Members of STANY also generally agree that regulation which restricts liquidity and hampers price discovery does a disservice to the markets. This disservice must be weighed against the realistic potential benefits of the regulation. As market professionals with specific knowledge of the functioning of the equity markets, we believe that price restrictions on short sales will negatively impact liquidity, will be difficult and costly to implement and enforce, and will ultimately provide no real value to the markets.

#### The Alternative Uptick Rule

The Commission accurately notes in the supplemental proposal that “Because it would only permit short selling at an increment above the national best bid, the alternative uptick rule would not allow short sales to get immediate execution, even in an advancing market, and therefore the alternative uptick rule would restrict short selling to an even greater extent than either the proposed modified uptick rule or the proposed uptick rule.”(*Emphasis added*) We agree with the Commission that the alternative uptick rule “...could potentially lessen some of the benefits of legitimate short selling, including market liquidity and pricing efficiency...” In keeping with our appreciation of the value of legitimate short selling and the restrictive nature of the alternative uptick rule, we have serious reservations about this proposed price test.

We are concerned about the potential unintended consequence that may result from restricting short sales to the degree contemplated by the alternative uptick rule. Given that short selling in the equity markets has never been limited to the type of passive short selling permitted under the alternative uptick rule, we can only speculate on the potential impact the rule might have on liquidity, volatility, pricing efficiency, and hedging strategies. We are also concerned about the potential for gaming.

Group One Trading LP, in a letter to the Commission dated September 14, 2009, raises a legitimate and troubling scenario in which computer algorithms sensing the presence of market participants passively shorting stock by placing sell orders exactly one increment above the NBB react to drive the market price of a stock rapidly downward. To paraphrase their letter:

*Computer algorithms will be able to identify the presence of short selling. These automated systems will quickly pull their bids in anticipation of the short selling, which would then lead to a drop in the price of the stock. As sellers continue to adjust their price downwards and stop limit orders are triggered, the price of the security will decline even further. Finally when the price reaches the short seller’s limits, the automated systems will quickly detect the limits and re-enter the buy orders leading to increased volatility.*

This possibility is real. Given the proliferation of algorithmic high speed trading and technology that senses and reacts to market movement with lightening speed; we do not doubt that market participants will be able to program systems to use the alternative uptick rule to move the markets rapidly. It is not hard to see how this rule, intended to boost public confidence in the markets, could easily have the opposite effect.

Proponents of the alternative uptick rule note that this version of a price test has implementation advantages over the other proposed price tests. We do not dispute that the implementation of the alternative uptick rule may be easier and less costly than implementation of the other rules being considered by the Commission. However, given that our markets have never been subject to the type of rule contemplated by the alternative uptick rule, we cannot accurately predict whether there will be unforeseen difficulties to implementation. Moreover, if cost and ease of implementation are the driving forces in the selection of regulation to curb abusive short selling, the least costly and easiest way to curb those abuses is enforcement of already existing regulation. Enforcement of existing regulation also has the benefits of being effective, as demonstrated by the successful diminution of naked shorting since the Commission implemented Rule 204T, and of being liquidity neutral.

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<sup>1</sup> Securities and Exchange Commission, 74 Fed. Reg. 18044 (Apr. 20, 2009)(17 C.F.R. 242)

The Commission should focus on the enforcement of existing regulation to curb abusive naked short selling.

Regardless of the potential pros and cons of the alternative uptick rule, we do not believe that reinstatement of a price test is necessary to address the concerns that have been expressed about short selling. Given the cost to implement a price test and the potential negative consequences of each of the proposed rules on the one hand and the lack of discernable positive impact of a price test on the other, we do not believe that the Commission should establish a price test for short sales. Existing regulation, if properly enforced, can efficiently and cost effectively address concerns associated with short sales without threatening liquidity and without substantial additional cost.

Rather than placing limitations on short selling activity, we suggest that the Commission enforce the strict settlement of fails to deliver, institute some form of reporting of short sales to market authorities, encourage effective compliance and enforcement systems designed to monitor settlement failures, and include appropriate exemptions for certain types of transactions necessary to the functioning and development of an efficient market.

We are confident that adequate regulation exists to address abusive practices and that the implementation of any price test will have little or no positive effect on curbing abuses. The SEC has a host of regulations which, when properly enforced, effectively regulate abusive and manipulative short selling. Rules 10b-5, 10b-21, 203 and 204T of the Exchange Act provide the Commission with more than adequate ammunition to police and prevent manipulative short selling. We commend the Commission for adoption of Rule 204T and encourage the Commission to enforce compliance with the rule. Unlike price tests, Rule 204T seems to have been remarkably effective in curtailing naked shorting.

If the Commission imposes a price test, it must include exemptions for market makers and options market makers. These exemptions are especially critical if the alternative uptick rule is implemented.

We recognize that the Commission has been pressured to address the issue of abusive short selling and that it is quite possible that the Commissioners will decide to enact some form of price test. We therefore wish to reiterate that it is critical that whatever final rule the Commission adopts include exemptions for bona fide domestic and international arbitrage, bona fide market makers and derivative and ETF market makers. These exemptions are needed so that hedging activity is not adversely affected and markets can continue to function effectively even with a price test. We are fearful that the lack of these exemptions would have the unintended negative consequence of causing market makers, especially in smaller less liquid stocks, and options to drop out of the market, or cease making markets.

Failure to include a market maker exemption would have even greater impact in the options markets. An exemption is especially critical for options market makers where short selling is necessary to facilitate options strategies and hedge against risk. Impairing option market makers' ability to provide liquidity will harm investors who seek to protect their equity positions through the use of options. Given that the alternative uptick rule is more restrictive than the other options in the Commission's original request for comment, it is even more critical that market maker exemptions be granted with the alternative uptick rule, especially as it would apply to the option market makers.

If the Commission is worried about abuses, rather than excluding these vital exemptions, it could define under what conditions a market maker exemption would be available and appropriate. We would suggest that if a firm is acting in the capacity of a bona fide market maker, with all of the obligations (maintaining continuous two sided quotes) and regulatory scrutiny attendant to market makers then an exemption should be available.

As expressed by STA in its letter to the Commission dated June 19, 2009

*Market maker exemptions were designed to provide relief to market making participants who had SUBSTANTIAL OBLIGATIONS to the market, which could be encumbered by the short selling rules. [We] believe that only those who have these obligations should be allowed to avail themselves of these exemptions, and then only when the obligated participants are engaged in bona fide market making required by these obligations. The current robust definition of market maker needs to be whittled down so that nearly one in four shares traded does NOT qualify for this exemption, as was the case during the emergency short selling ban of September and October 2008.*

If the Commission decides to impose a price test, we urge testing through a pilot program before permanent adoption of restrictions.

Although we believe that short selling should not be restricted by a price test, if the Commission concludes that such a test will contribute to market stability and will not significantly impair the benefits of short selling, we believe that the price test selected by the Commission should be subjected to thorough analysis and testing through a pilot program. A pilot program will allow the Commission to assess the efficacy of the amendment to Reg. SHO in a Reg. NMS environment and determine if the costs and difficulties of implementation are supported by a positive change in the functioning of the markets. A pilot will also allow the Commission to monitor the impact of the selected rule on liquidity, price volatility, spreads and trading costs. The need for testing the rule via a pilot program is even more important with the alternative uptick rule. Its restrictive nature and the fact that passive short selling has not been tested in the past, heighten the need for a pilot program.

Summary

Amendments to Reg. SHO should not be implemented unless the Commission truly has reason to believe that the amendments will bring substantial benefits to the markets, which so far has not been demonstrated. If the Commission is intent on amending Reg. SHO, then the Commission should make changes that are the least burdensome and that protect the benefits of short selling to the greatest possible extent. Perhaps the alternative uptick rule would be a viable alternative if the cost and ease of implementation were the only concerns with reinstatement of a price test. However, since the alternative uptick rule is also the most restrictive of the proposed rules, it is likely to have the greatest impact on the benefits to the market provided by legitimate short selling.

Lastly, we urge the Commission to include exemptions for bona fide market makers and option market makers, in any rule that it elects to implement. Without an exemption to a price test, these liquidity providers will be unable to render valuable service to the markets. The potential negative impact, especially in thinly traded stocks and options should not be underestimated.

We thank the Commission for the opportunity to provide these comments and would be happy to speak with the Commissioners and staff about our position. Please do not hesitate to call upon us if we may be of assistance.

Respectfully submitted,

Kimberly Unger  
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