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Securities and Exchange Commission
100 F St. NW
Washington, DC 20549-9303
Rule-comments@sec.gov

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Dear Securities and Exchange Commission:

Here are my comments on the latest Regulation SHO re-proposal that proposes additional restrictions on short selling such as a price test and/or a circuit breaker:

The SEC has received thousands of complaints from angry investors demanding that it DO SOMETHING about short selling. Many of these investors are not very sophisticated about the details of today's financial market operations. The SEC, however, should not ignore their complaints. They have an intuitive sense that something is wrong, even if their ignorance makes them push for the return of useless rules such as the old uptick rule. At the same time, the SEC should live up to its duty as a knowledgeable regulator to whom Congress entrusted the specialized task of regulating our markets. The SEC has a duty to see the big picture and act in the best interests of the public, despite the political pressure resulting from the recent financial meltdown.

The big picture is that today's warp speed computerized markets contain the potential for another financial catastrophe at warp speed. If an algorithm at a large financial institution misfires, whether because of an honest malfunction or sabotage, it could create an enormous critical chain reaction that would cause a tsunami of economic destruction within milliseconds. Yet we currently rely on slow humans at our exchanges to make decisions. We need automated circuit breakers that function on a stock by stock basis that will kick in instantly when something goes haywire. To date, the SEC has taken the same approach to such warnings as FEMA took to warnings that New Orleans was vulnerable to a Category 5 hurricane. Do we need a Category 5 meltdown in the equity market before the SEC moves to take action to prevent such a preventable calamity? The individual exchanges cannot act on their own because of the competitive fragmented nature of our modern markets. If a single exchange halts trading, it stands at a competitive disadvantage to its competitors. Dealing with this threat requires intelligent coordinated action by the SEC.

In addition to the threat of a high speed meltdown, there is concern among some that, even without significant algorithmic errors, the market has exhibited excessive short-term volatility. This is more than just a short selling issue. The SEC should consider short selling in the context about what, if anything, to do about excess volatility.

The SEC also has a very important duty to get it right because short selling represents over 25% of current stock market volume. Any rules considered in an area that covers such a large fraction of total trading volume need to be thought through very carefully. The SEC should experiment with another carefully controlled pilot program to explore the impact of any proposed rule changes, otherwise the unintended consequences for market liquidity and volatility could be extremely severe.

With short selling, we face The Good, The Bad, and The Ugly. The challenge of the regulators is to keep the good side of short selling (providing liquidity, keeping derivative and ETF prices where they should be, price discovery, and so forth), while containing the bad (piling on by momentum investors when a stock is going down), and eliminating the ugly (intentional failures to deliver and price manipulation).

Many market observers feel there is a need for a brake on short selling when markets are going down. Such a brake is needed only when markets are under stress. When driving a car, you don't want the brakes dragging all of the time.

The proposal to put in a "modified uptick rule" would be a big mistake if it were to apply at all times. Such a rule would effectively ban all short selling with market orders. This would affect the good short selling as well as the bad and the ugly. It would be like having a brake on the car that is dragging all the time. It would be much better to allow totally unrestricted short selling on days when a stock is going up, so that short sellers can play their appropriate role in dampening volatility and preventing stocks from becoming overpriced. It would only make sense to impose restrictions on short selling, such as the proposed modified uptick rule, when a stock is in rapid freefall. Thus, such a restriction should only be applied after a stock has dropped 5% or more. Furthermore, any changes need to be thoroughly tested through pilot experiments to make sure that the changes do not cause market quality to deteriorate.

Respectfully submitted,

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Previous comment letters by James Angel, Georgetown University, on short selling and Regulation SHO and incorporated by reference:

http://www.sec.gov/comments/s7-08-09/s70809-3758.pdf
http://www.sec.gov/comments/s7-20-08/s72008-521.pdf
http://www.sec.gov/comments/s7-19-07/s71907-117.pdf
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