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Nancy M. Morris
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: File No. S7-20-06 - Regulation M Rule 105

Dear Ms. Morris:

We appreciate the opportunity to comment on the Securities and Exchange Commission's ("SEC" or "Commission") proposed amendments to Rule 105 (Short Selling in Connection With a Public Offering)[1] of Regulation M.[2] New York Stock Exchange Regulation ("NYSE" or "Exchange") applauds the efforts of the Commission in proposing amendments to Rule 105 which will promote market integrity by precluding persons from engaging in manipulative conduct around the pricing of an offering so that markets can be fairly determined by supply and demand without the influence of artificial forces.

Rule 105 is designed to prevent short selling activities that artificially depress market prices which can lead to lower than anticipated offering prices. Despite interpretive guidance from the Commission regarding the application of Rule 105, violations of the rule have persisted, including a proliferation of trading strategies and structures attempting to accomplish the economic equivalent of the activity the rule seeks to prevent. As such, the Exchange supports the Commission's proposal to amend Rule 105 to expand the current standard which prohibits covering a restricted period short sale with offered securities to now prohibit any purchase of an offered security for any reason, whether the intent is to cover the short sale or otherwise.[3]

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1 17 C.F.R. 242.105.

2 17 C.F.R. 242.100-105.

3 See Release No. 34-54888 (December 6, 2006) ("Short Selling Connected with a Public Offering"); 71 FR 75002 (December 13, 2006). A person "purchases," including entering into a contract for sale for, a security when the person becomes irrevocably committed to purchase the security.

The proposed amendments to Rule 105 meaningfully address the proliferation of trading strategies and structures, which are designed to disguise prohibited covering activity, by prohibiting any purchase of offered shares by someone who sold short during the restricted period. By eliminating the covering component and expanding the prohibition to all purchases of offered securities, the proposed amendments will efficiently prevent persons from engaging in strategies to avoid the appearance that offering shares are being used to cover Rule 105 restricted period short sales. The proposed amendments to Rule 105 will bolster investor confidence, further the prophylactic nature of the rule and prevent manipulative activity around the time an offering is priced. Additionally, the proposed amendments will protect independent pricing mechanisms and price integrity and advance the intent of Regulation M, which is to prevent market manipulation and facilitate offering prices based on the natural forces of supply and demand, unencumbered by artificial influences.

The Exchange does not believe that the proposal is unduly burdensome. The amendments, as proposed, do not ban short sales prior to an offering outright, thus they do not hamper true price discovery. A person may continue to sell short prior to the restricted period and then purchase shares of the security during the offering. Also, a person may still effect a short sale during the restricted period, provided they do not purchase shares of the offering. Such permitted short sales are useful because this activity usually indicates that the person effecting the honestly sale believes the security is overpriced. Permissible short sales provide a natural price discovery mechanism for the market and, as such, should not be restricted. The Commission has also proposed to amend Exchange Act Rule 10a-1[4] by removing restrictions on the execution prices of short sales ("tick tests") and prohibiting any SRO from imposing a price test on short sales.[5] The Commission proposed a related amendment to Regulation SHO[6] to remove its requirement to mark a sell order as "short exempt" if the seller is relying on an exception from a price test.[7] These proposals evidence other initiatives by the Commission to facilitate permissible short selling by marker participants.

The prophylactic nature of Rule 105 eliminates the need for the SEC to examine each trading strategy variation on a case-by-case basis. However, the Commission solicits comment in the Rule 105 proposal as to whether the prohibition against all purchases of offered securities is overly restrictive and eliminates legitimate short sales. Specifically,

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4 17 CFR 240.10a-1.

5 See Exchange Act Release No. 54891 (December 7, 2006); 71 FR 75068 (December 13, 2006).

6 17 CFR 242.200 et seq.

7 See Exchange Act Release No. 54891 (December 7, 2006); 71 FR 75068 (December 13, 2006).

the Commission solicits comment as to whether the proposed rule should allow for an exemption to allow a person who effects a restricted short sale to purchase the security in the offering if, after effecting the restricted period short sale but before pricing of the offering, the person closes out the entire short position on an offered security with an open market purchase, during regular trading hours, that is reflected on the tape.

The Exchange believes that an exemption from Rule 105 is unnecessary. Rule 105 should apply to any type of security or derivative for which a downward price manipulation could occur by covering short sales with offering shares of any kind. In the event that a person closes out an entire short position before an offering, there should not be an exemption to allow the person to participate in the allocation of offering shares. Although there could be non-manipulative situations where a person effects a restricted short sale and then covers the entire short position prior to the pricing of an offering, the time period in which to close the restricted period short position should not be near the pricing of the offering. Short sales have the effect of driving down the price of a security, even if covered in the open market. An exemption would undercut the prophylactic nature of the rule because there may be trading strategies designed to get around the prohibition with many open positions which would invite case-by-case examination by the Commission.

The Commission requests comment as to whether Rule 105 should remain limited to offers conducted on a firm commitment basis. The Exchange believes that Rule 105 should apply to any type of offering in which there is potential for manipulative activity by way of short selling prior to the pricing of an offering, i.e., any offering or arrangement that lends itself to the abuse that the rule is designed to prevent. This could include a rights offering because such offerings enable a holder to purchase shares of a security at a discount and, therefore, such an offering could be a platform for manipulative conduct. Also, the Exchange believes that Rule 105 should apply to short sales effected prior to the exercise of conversion rights if there is the potential for manipulation in this activity.

Rule 105 currently does not apply to short sales of derivative securities. The Commission did not initially apply Rule 105 to derivatives because the focus of Regulation M was limited to securities that have the greatest manipulative potential. In the proposal, the Commission requests comment on trading strategies involving derivatives that may produce similar effects in ways not covered by the proposal, and whether derivatives should be included in the proposed amendments to Rule 105. Evidence suggests that derivatives strategies, including married puts and sham swap transactions, have been utilized to avoid the prohibitions of Rule 105.

The Commission has issued interpretive guidance with respect to specific trading strategies (i.e., married put transactions) which disallows the aggressive use of such due to the proliferation of manipulative activity where short sales were made on a negative tick in order to drive down the price of the offering. The Exchange has witnessed assorted situations where firms engage in trading strategies that attempt to obfuscate links between equities and derivatives in connection with these strategies. New creative strategies that involve other derivatives which fall outside these parameters are likely in the future.

The use of derivatives as part of trading strategies designed to evade Rule 105 are prohibited under Section 20(b) of the Exchange Act.[8] Given the proliferation of this intentional manipulation of the market, the NYSE supports efforts by the industry to address the use of derivatives to disguise illegal covering activity. The focus of these efforts should be to expose activities that intentionally circumvent the prohibitions of Rule 105 or otherwise manipulate the market around an offering of securities. These efforts should, at a minimum, evaluate trading strategies using a sampling of different types of derivatives and assess the consequences of such conduct on the market, issuers and investors. Results from an industry effort to expose these strategies will allow the Commission and the securities industry, at large, to determine whether future rulemaking is necessary with respect to derivatives in this area.

Sincerely,

Richard Ketchum

8 15 U.S.C. 78*t*(b). This provision prohibits a person from doing indirectly any act that he is prohibited from doing directly by the Exchange Act, or any rule thereunder, through or by means of any other person. This activity could include transactions where an intermediary is used to purchase shares in the offering to cover the restricted period short position. See Release No. 34-50103 (); 69 FR 48008 (August 6, 2004).