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Via Electronic Filing

Ms. Nancy M. Morris
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-1090

Re: File No. S7-20-06 – Short Selling in Connection with a Public Offering
(Release No. 34-54888)

Dear Ms. Morris:

We are submitting this comment letter on behalf of one of our clients, a registered investment adviser to various funds, in response to the request by the Securities and Exchange Commission ("SEC" or "Commission") for comments on its proposing release concerning amendments to Rule 105 of Regulation M under the Securities Exchange Act of 1934 ("Exchange Act").[1] The views expressed in this letter are those of our client.

Current Rule 105 prohibits a person from covering a short sale effected during a "restricted period" before a secondary offering with securities purchased in that offering. The "restricted period" for purposes of Rule 105 covers the shorter of (i) the period beginning five business days before the pricing of the offered securities and ending with such pricing, or (ii) the period beginning with the initial filing of the registration statement or notification on Form 1-A and ending with the pricing. In the Commission's view, short selling near an offering can have a substantial adverse, and distorting, effect on the market price of the securities and may interfere in the offering process.[2] The SEC further believes that a large amount of short selling before an offering is likely to depress the market price of the stock, which will depress the price of the offering to the detriment of other holders of the security, as well as the issuer and/or selling shareholder. As a result, the SEC precludes persons short selling in the restricted period from using securities received in an offering to cover the short sales. This is intended to ensure that any short selling that does occur at that time is part of true price discovery, and not merely to lock in profits without corresponding market risk.

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[1] *See* Release No. 34-54888 (Dec. 6, 2006), 71 FR 75002 (Dec. 13, 2006) ("Proposing Release").

[2] Proposing Release, 71 FR at 75003.

The Commission's proposal, however, would expand the scope of current Rule 105 to make it unlawful for a person to effect a short sale in a security during the Rule 105 restricted period and then purchase, including enter into a contract of sale for, that same security in a secondary offering, regardless of whether the securities purchased are used to cover the short sale. The basis for the amendment is the Commission's assertion that it is aware of non-compliance with current Rule 105 today, and "a proliferation of trading strategies and structures attempting to accomplish the economic equivalent of the activity that the rule seeks to prevent."[3] For example, a person might sell short during the Rule 105 restricted period, purchase shares in the secondary offering, and subsequently buy and then sell the securities in the open market. That person might assert that the open market purchase covered the short sale and the open market sale closed out the long position from the offering securities.

Our client, a registered investment adviser, is extremely concerned that the amendments to Rule 105 proposed by the Commission will have a disparate negative and unfair effect on funds advised by registered investment advisers that utilize multiple investment strategies or employ multiple sub-advisers. Our client acts as investment manager to such funds and delegates trading activities to (a) several clearly identified internal portfolio managers and, (b) to a more limited extent, sub-advisers. Each portfolio manager and sub-adviser is evaluated and compensated based on the profitability of its own trading strategy. Nevertheless, a fund may be deemed a single "person" under Rule 105 despite the fact that different portfolio managers and sub-advisers of the registered adviser act on behalf of the fund independently from one another. Under current Rule 105, if one portfolio manager or sub-adviser using a statistical arbitrage strategy happens to sell a security short during the Rule 105 restricted period, another portfolio manager or sub-adviser using a fundamental directional strategy could nevertheless participate in an offering of those same securities, as long as the shares the second manager purchased in the offering were not used to cover the short position of the first manager. Under this scenario, each manager separately is exposed to market risk, and the short selling manager cannot "lock in" any profits on the offering shares because it is not participating in the discounted offering.[4]

If the proposed changes to Rule 105 are adopted, however, the fund would inadvertently violate the rule in the same scenario, despite the fact that the fundamental strategy manager did not engage in any short selling and his trading is not coordinated with that of the short-selling manager. Our client believes that this result unfairly penalizes the funds it advises, even though the investment adviser's structure ensures that there is little risk of it engaging in the types of

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[3] Proposing Release, 71 FR at 75002.

[4] In fact, our client employs policies and procedures to ensure that this prohibition – that offering shares are not used to cover a short position put on during the restricted period – is strictly followed.

underlying activity that Rule 105 is designed to address.[5] Because the short sale and the subsequent participation in the offering were conducted by separate portfolio managers or sub-advisers employing different trading strategies in this example, there can be no "locking in" of profits based on the discounted price of the offering shares. In addition, the short selling manager cannot benefit by any lowered offering price as a result of downward pressure through his short selling without incurring the market risk of an open market purchase because he is not purchasing shares in the offering. Consequently, the short seller has no reason to sell short to affect the offering price for an improper purpose. The short sale instead would have been a legitimate transaction with market risk for that manager because it was not linked, in any way, to the subsequent acquisition of offering shares by the other manager.

If the Commission decides to adopt the proposed amendments to Rule 105, our client urges the SEC extend the concept of independent trading unit aggregation under Rule 200(f) of Regulation SHO to funds with registered investment advisers.[6] Extending the aggregation unit principles in Rule 200(f) to funds that are advised by regulated entities would permit the investment adviser acting on behalf of its clients to employ separate portfolio managers and sub-advisers to manage discrete and separately identifiable accounts to continue operating under their current business models while ensuring that the harm to the market and market participants that Rule 105 was intended to address is prevented. The Commission should consider which of the conditions imposed in Rule 200(f) on broker-dealers seeking to use the aggregation unit concept – (1) that the broker-dealer has a written plan of organization that identifies each aggregation unit, specifies its trading objective(s) and supports it independent identity; (2) each aggregation unit within the firm determines, at the time of each sale, its net position for every security that it trades; (3) all traders in an aggregation unit pursue only the particular trading objective(s) or strategy(s) of that aggregation unit and do not coordinate that strategy with any other aggregation unit; and (4) individual traders are assigned to only one aggregation unit at any one time – can reasonably be applied to an investment adviser employing separate portfolio managers and/or

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[5] In addition, if amended as proposed, the new Rule 105 could, in effect, give a veto power to one portfolio manager over the trading strategies of another portfolio manager – if any manager engages in short selling during a Rule 105 restricted period, all other managers for the fund would be precluded from participating in the offering. The fund would have to either (i) preclude any short selling by any trader during the restricted period before an offering, (ii) allow short selling in the Rule 105 restricted period and thereby restrict participation in follow-on and secondary offerings by any of its traders, or (iii) make a choice as to which strategy it will permit in connection with each offering. This latter option, however, presumes that it will be aware of each upcoming offering at the time a short sale is considered and it would be able to block short sale orders from those managers from being effected while it decided its course of action. Each of these three options creates trading inefficiencies, which ultimately can negatively impact fund shareholders.

[6] The Commission explicitly requested comment on the application of the aggregation principles in the context of Rule 105 to non-broker-dealers, including investment companies. *See* Proposing Release, 71 FR at 75007.

sub-advisers to trade the fund's assets. In essence, for the same reasons broker-dealers are permitted to use aggregation units, funds also should be able to use aggregation units.

In the case of a registered broker-dealer operating within the current aggregation unit construct, the Commission has the ability, through its examination authority and through SRO oversight, to monitor the broker-dealer for compliance with the conditions of Rule 200(f). The Commission can do the same for funds which use registered investment advisers. Although our client's advised fund is not itself registered, the Commission has oversight of our client, the registered adviser, and could monitor use of aggregation units by the fund through its examination of the adviser.[7]

We appreciate the Commission's consideration of our client's views as expressed above, and we would be happy to discuss these comments further with the Commission or its staff if they seek additional information or clarification.

Respectfully submitted,

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[7] As our client is a registered investment adviser, we are only commenting on the use of the aggregation unit approach to funds with registered advisers. We do not want to suggest that the Commission is precluded from reaching a determination that use of the aggregation unit approach by funds with unregistered advisers also is appropriate.