

# E\*TRADE FINANCIAL

E\*TRADE Brokerage Holdings, Inc.

Ballston Tower  
671 North Glebe Road, 12<sup>th</sup> Floor  
Arlington, VA 22203

February 9, 2007

Nancy M. Morris, Secretary  
United States Securities and Exchange Commission  
100 F Street, N.E.  
Washington, DC 20549-1090

Re: File No. S7-21-06 (Amendments to Regulation SHO and Rule 10a-1)

Dear Ms. Morris:

E\*TRADE Financial Corporation and its subsidiaries (collectively, "E\*TRADE")<sup>1</sup> appreciate the opportunity to comment on a significant proposal recently issued by the Securities and Exchange Commission ("SEC" or "Commission") to remove all short sale price tests under the Securities Exchange Act of 1934 ("Exchange Act").<sup>2</sup> E\*TRADE commends the Commission for its past efforts regarding short sale regulation and for its decision to issue the current proposal. Our general view is that short selling enhances market liquidity and contributes to stock pricing efficiency, and thus is an important part of our securities markets, and that the existing restrictions on the execution prices of short sales ("price test restrictions") inhibit the free-market price discovery mechanism of an efficient market. Accordingly, we fully support the Commission's proposal to eliminate the current price test restrictions.

This proposal is a result of the many years of experience by the SEC on the operation of price test restrictions for short sales, the amendments to Exchange Act Rule 10a-1 to add various exceptions, and consideration of numerous written requests and granting exemptive relief from its restrictions.<sup>3</sup> Most importantly, the Commission's Office of Economic Analysis has

---

<sup>1</sup> The E\*TRADE family of companies provides a broad array of financial services to both retail and institutional customers and includes brokerage firms engaged in retail, institutional trading (both agency and proprietary), clearing and market making businesses, as well as firms engaged in banking, mortgage lending and investment advisory businesses. Our U.S. brokerage business comprises the activities of the following registered broker-dealers: E\*TRADE Securities LLC, E\*TRADE Clearing LLC and E\*TRADE Capital Markets, LLC.

<sup>2</sup> 71 FR 75068 (December 13, 2006) (Release No. 34-54891) ("Proposing Release").

<sup>3</sup> The Commission has granted exemptions, among others, for transactions in exchange traded funds and for certain transactions executed on a volume-weighted average price basis. The Commission notes in the Proposing Release that these and other exemptions potentially create an unlevel regulatory playing field among market participants.

had the opportunity to carefully analyze the empirical data gathered during a pilot period during which the price test restrictions for certain securities were suspended under Rule 202T of Regulation SHO, including three completed academic studies from outside researchers who examined the pilot data. The Commission also held a public roundtable discussion focusing on the empirical evidence from the pilot data. After carefully analyzing the empirical data and views from the public, the Commission has concluded that the results of the pilot generally supported removal of current price test restrictions and that the empirical evidence did not support extending a price test to either small or thinly-traded securities.<sup>4</sup>

In the past, the “tick test” included in Exchange Act Rule 10a-1 and the “bid test” for Nasdaq securities<sup>5</sup> have served their purpose in ensuring that abusive short selling is not used as a tool for driving down the market in “bear raids.” However, in today’s market with the high level of transparency and real-time regulatory surveillance, the SEC and self-regulatory organizations (“SROs”) can easily monitor and detect any short sale manipulation and use the general anti-fraud and anti-manipulation provisions of the securities laws to prohibit and sanction such activities.<sup>6</sup> E\*TRADE, like other broker-dealers and market participants, currently expends significant financial, technology and human resources on ensuring compliance with price test restrictions. Compliance costs and the loss of market benefits created by short sales (*e.g.*, added liquidity and pricing efficiency as noted above) outweigh any potential and theoretical regulatory benefits of price test restrictions. E\*TRADE believes now is the time for the SEC to remove all short sale price test restrictions.

E\*TRADE also supports the proposal to prohibit SROs from having a price test, such as Nasdaq Rule 3350 and NASD Rule 5100, which would achieve market simplification and regulatory consistency.<sup>7</sup> Without such a prohibition, any SRO may have its own price test for securities that are traded on its market, which would create a regulatory environment applying different tests to securities trading in different markets and would increase compliance and system change costs to market participants including broker-dealers executing customer short sales.<sup>8</sup>

---

<sup>4</sup> Proposing Release at 75069. Many thinly-traded securities, such as securities quoted on the OTCBB and pink sheets, currently are not subject to any price test restrictions.

<sup>5</sup> Nasdaq Rule 3350 (Nasdaq’s bid test providing that short sales in Nasdaq Global Market securities must not be effected at or below the current national best bid (“NBB”) when the current NBB is below the preceding NBB); NASD Rule 5100.

<sup>6</sup> *See, e.g.*, Securities Act of 1933 Section 17(a); Exchange Act Sections 9(a), 10(b) and 15(c) and Rule 10b-5.

<sup>7</sup> This would be accomplished by adopting Rule 201(b) of Regulation SHO.

<sup>8</sup> With the adoption of these two amendments, the “short exempt” marking requirement of Rule 200(g) of Regulation SHO would no longer be applicable. E\*TRADE supports the removal of the marking requirement.

Nancy M. Morris, Secretary  
February 9, 2007  
Page 3

In conclusion, E\*TRADE believes the time has come for the Commission to eliminate all short sale price test restrictions for all securities, which will benefit (1) the market in general by creating a level regulatory playing field and adding market liquidity through short sales, (2) those investors who engage in short sales by permitting executions of short sale orders without any delay due to a price test, and (3) market professionals including broker-dealer firms by saving significant resources from short sale price test compliance.

\* \* \* \* \*

We appreciate this opportunity to submit our comments supporting the Commission's proposal. If you have any questions or would like to discuss our comments, please do not hesitate to contact me at (703) 236-8598.

Sincerely,



S. Kevin An  
Deputy General Counsel  
E\*TRADE Brokerage Holdings, Inc.

cc: The Hon. Christopher Cox, Chairman  
The Hon. Paul S. Atkins, Commissioner  
The Hon. Roel C. Campos, Commissioner  
The Hon. Annette L. Nazareth, Commissioner  
The Hon. Kathleen L. Casey, Commissioner