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Ms. Nancy M. Morris, Secretary  
Securities and Exchange Commission  
100 F St. NW  
Washington, DC 20549-9303

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File No. S7-21-06: Regulation SHO and Rule 10a1

Dear Ms. Morris:

Here are my comments on the proposed changes to Regulation SHO and Rule 10a1. In brief:

- Eliminating the uptick rule is a great idea.
- Conducting a scientifically controlled pilot experiment was the right way to make the decision. The Commission should follow this precedent in the future.
- Tick-by-tick data on short sales should be made available after the end of the pilot as a field in the TAQ and NASTRAQ data products.
- The locate rule is an important brake on unrestricted short selling but will lose its effectiveness in the future.

I commend the Commission for both the decision to eliminate the price tests and the manner in which it was made. The Commission has set an excellent precedent for scientific rulemaking by conducting a carefully controlled pilot project. Instead of basing rules on theory and instinct, the Commission has gathered solid evidence that the price tests can be eliminated without harming investors. Eliminating the rule will remove an expensive compliance headache that produced no benefit for investors.

I recommend that the Commission conduct such controlled experiments in the future in other rulemaking areas.

One particular benefit of the pilot is the tick-by-tick information that became available on short selling. This data has led to a much greater understanding of the role of short selling in our markets. I urge the Commission to work with the exchanges to make sure that similar data continues to be available to researchers after the end of the Pilot.

As the markets are continuing to evolve rapidly with Regulation NMS and global consolidation, such data will be important for monitoring and understanding the future changes in the markets.

Another very important reason to continue to make tick-by-tick data on short selling available is to remove suspicion from the market. Short sellers are often blamed for all manner of bad things in the market. By making such data public, investors can see for themselves the impact of short selling on the market. This will reduce the burden on the SEC to investigate allegations when there is no wrongdoing, and it may also help the public to spot wrongdoing and bring it to the attention of the SEC.

The cost of continuing to make such data available should be miniscule. The exchanges already collect and disseminate the data, so there is no need for a massive data collection effort. My only suggestion would be that the data be combined with the trade and quote databases that the exchanges already sell. The current data format makes it very difficult to match the short trade data with the regular trades and quotes database. I recommend disseminating the short data as an additional field in the TAQ and NASTRAQ databases.

I would like to have a further thought as to why a price test may have made sense in the 1930s but is no longer needed today. Many changes have occurred in the equity market since the 1930s. Markets are much more transparent and much more closely monitored now. Disclosure is much better, and improved communications mean that more information is easily available to investors. Furthermore, the locate rule adds an important protection. In general, short sellers must either borrow the stock or have “reasonable grounds” to believe that the security can be borrowed. There are, of course, appropriate exemptions for market makers who must provide liquidity on short notice. The location rule serves as a natural circuit breaker in the event of a severe price drop by reducing the ability of sellers to accelerate the downturn through unlimited short selling. The location rule also prevents a manipulator from improperly driving down the price by dumping an unlimited number of shares on the market.

Currently, the stock loan market is quite fragmented and greatly resembles the old over-the-counter market before the creation of NASDAQ. The typical broker works with a fairly small set of regular counterparties to borrow and lend stock. If those counterparties have no stock available, the broker will not proceed with an order to sell short. These frictions in the stock loan market serve as a brake on short selling activity for hard-to-borrow securities.

However, improvements are creeping into this sector and it is slowly becoming more efficient. In a well functioning market, there is almost always supply available – for a price. Thus, as the stock lending market matures, the locate process will be easier, more automated, and more meaningless. Market forces will determine the price of a stock loan, but stock will be available in almost all cases. This means that the role of the locate rule as a brake on short selling during extreme market events will eventually disappear.

In light of this, the Commission may wish to consider regulations similar to those in China that curtail short selling when more than 25% of the float has been borrowed.

Cheers,

James J. Angel, Ph.D., CFA