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Securities and Exchange Commission
Sub: Conclusive Evidence in favor of Reviving the Uptick Rule

Dear Dr. Sirri,

Here is a matter of utmost importance. Millions of Americans have lifetime savings in stocks and mutual funds. Our leaders are worried whether our nation will fall into a deep recession or worse, into depression. We are seeing events occurring in equity markets that had occurred during the Great Depression of 1929 – 1933. We have seen Dow Jones and S&P 500 moving by 8% -10% in a day. Evidence suggests that the repeal of the uptick rule has played a crucial role. Several arguments are presented here for your immediate review and action:

1. Bear raids - “The SEC's fateful decision to repeal the rule has exposed us to the very same "bear raids" and "runs on the banks" that prompted the rule's original enactment in 1934. Prudent lessons learned from the crash of 1929 and the ensuing Depression have been unlearned and, in the process, left us unprotected from predatory trading abuses”, say editors of the Investor Business Daily [Reference 1].

In a Wall Street Journal (Nov 18, 2008) article titled –“There's a Better Way to Prevent 'Bear Raids'. The SEC should restore the uptick rule.”, the authors say, “The SEC was warned by two commentators not to repeal the uptick rule since it limited "bear raids" -- when short sellers drive down a stock's price in the hopes of scaring other investors into dumping the stock or triggering margin calls to force liquidations. In response, the agency approvingly summarized the views of three other commentators -- that bear raids "are highly unlikely to occur in today's markets, which are characterized by much smaller spreads, higher liquidity, and greater transparency than when the rule was adopted 70 years ago." This summary did not take into account another factor -- the advent of over $1 trillion managed by hedge funds with the ability to short stocks..

In fact, after the repeal of the uptick rule, there was a marked increase in the number of NYSE-listed stocks with price drops of over 40% in a day -- a rough proxy for a bear raid. In the 12 months following Sept. 30, 2007, the number of such huge drops doubled as compared to a prior period with similar market declines and high volatility -- the 12 months following March 31, 2000.” [Reference 2]

2. Pilot tests – SEC conducted pilot study on 1000 stocks before removing the price test (uptick rule or bid test). SEC indicated that there was no difference between “uptick rule” and “no uptick rule” groups. Recently, Professor Yaneer-

Bar-Yam, who has Ph.D. in Physics from MIT, and Dr. Dion Harmon, who has Ph.D. in Mathematics from MIT, conducted a thorough analysis of SEC's pilot data and found that there was statistically significant difference in returns. For stocks with no uptick rule, returns were lower by 2.3 percent in a 6-month period (4.6 percent annualized). They plotted returns of uptick rule and no uptick rule stocks. The lower returns of "no uptick rule" group are visually obvious. This alone negates SEC's original argument in support of the repeal of the rule. [Reference 3]

The authors conclude, "Taken together, this information strongly implicates the uptick rule repeal as a major contributor to, if not the outright cause of, the current severe financial crisis—a crisis that is greater than any since the crash of 1929 and the subsequent turmoil of the early 1930s. The prevention of such conditions was the original motivation for the uptick rule."

3. Decimalization and the uptick rule – The Wall Street Journal reported on November 21, 2008 that SEC Chairman Christopher Cox has opposed reinstating the uptick rule, arguing that it is no longer effective since stock prices moved to pennies from fractions [Reference 4]. SEC used the same argument in its final rule to remove the price test [Reference 5]. This is sad because this argument is completely incorrect.

Having up tick, how so small, even 0.001 penny prevents downward price manipulation. Let us say, you want to short a stock trading at a bid of 21 and ask of 21.02. With the uptick rule (price-test) in place, you could not short it below 21.02. (Uptick rule was used by NYSE. Nasdaq used bid test that relied on bids of the last sale as floor but the effect is nearly the same.) When price test is used, for every short sell, there need to be bids at the same level or higher, in quantities sufficient for shorting. You cannot force the stock price low simply by short selling.

Now, compare it to the present "No uptick required" scenario. Imagine in the above example bids of 400 shares at 21, 1200 shares at 20.97, 2000 shares at 20.90, 600 shares at 20.82, 1000 shares at 20.75. A short seller can place a market order to short 5000 shares and take down the stock to 20.75. If he is a hedge fund manager with deep pockets, he can take down the stock a lot more. It would be like a freight train mowing those in front.

Many have said correctly that if you have the price test (uptick rule or the bid test), with decimalization, it is easier than before to short, but that does not justify not having the price test at all. You could have a difference of 0.000001 penny between the bid and the ask and still have an effective uptick rule to protect from predatory shorting. That is the genius of Joe Kennedy, the first SEC chairman who implemented the rule. (Joe Kennedy had been a short seller during 1929-1931 bear raids!)

4. Increased volatility – Removal of uptick rule makes unfettered shorting. Sometimes, things do not work out for shorts and they cover rapidly sending prices up. That enhances volatility. There is clear empirical evidence that S&P 500 VIX (volatility measure) jumped from 12.7 to 21.6 once the rule was removed. [Reference 6]

5. Low volume stocks, liquidity - There are several thousand securities, of small and midsize companies, that have low liquidity and trading volumes below a million shares a day. These securities are more prone to abusive shorting, because their bid – ask spread is larger.. American Exchange had warned SEC that more studies were needed before removing the uptick rule for smaller issues [Reference 5]. SEC ignored the warning without explanation and repealed the price test for all securities.

6. SEC relying on input from short seller firms – In response to mounting public pressure, SEC officials (yourself) finally announced on October 6, 2008 that the Commission was reviewing the idea to reinstate the uptick rule. However, sadly, SEC has relied on people from BATS Trading, UBS, Goldman Sachs, Morgan Stanley. [Reference 7] These firms serve the interests of traders and short sellers. Of course, they are going to recommend against reviving the rule. You need to listen to investors, not security traders associations or industry groups serving short sellers!

7. Investors' view – SEC's solemn obligation is to look after interests of millions of Americans who own stocks and mutual funds. Investors overwhelmingly want the uptick rule reinstated permanently. In an NYSE poll, 85% of respondents thought the SEC and financial markets should re-institute the 'tick test' rule, along with other options designed to place some constraints around short selling. Respondents at US-based companies in particular were in favor of re-instituting the rule and thought it would help instill market confidence [Reference 8]. Similarly, Wall Street Journal poll of about 1000 investors revealed that over 80% wanted the uptick rule back [Reference 9]. SEC must seriously and quickly accept these very strong inputs from investors.

8. Prompt action required – Above all, SEC must act immediately. A week from now or a few weeks or a month from now is late. This is a matter of highest importance to all of us. The falling stock prices will drive this nation to 1929 like depression. Citigroup is on the verge of collapse. Experts from Wall Street Journal, CNBC, and Investor Business Daily, Senators from both parties, analysts with MIT Ph.D.s, everyone asking for the revival of the rule, also stresses the urgency. These people are no fools. In light of this, even if SEC has some hesitation, even if SEC needs more time for analysis or tests, it must proceed quickly to reinstate the rule first because you know that the rule worked well for seventy years. At worst, it may not fix the problems that many believe it will; still, it is not going to be harmful. SEC has emergency powers to reinstate

the rule, and as NYSE’s chief says [Reference 10], it can be implemented quickly. It will be the best decision Chairman Cox will have made.

So please for the sake of the well being of our nation, reinstate the rule now.

Thank you.

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