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September 25, 2008

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Commissioner Troy A. Paredes
Commissioner Elisse B. Walter
Erik R. Sirri, Director, Division of Trading and Markets
Robert L.D. Colby, Deputy Director, Division of Trading and Markets

Securities and Exchange Commission
100 F. Street, N.E.
Washington, DC 20549

Re: Short Sale Order – Impact on Convertible Arbitrage Market

Dear Sirs and Madams:

The U.S. convertibles market comprises $300 billion in corporate securities. Recently, this market has been dramatically affected by three factors:

1. Many U.S. financial firms including Lehman Brothers, Washington Mutual, Fannie Mae, and AIG, collectively raised over forty billion dollars in this market in the last year – see the attached list. Valuations on this debt have fallen drastically – in some cases almost to zero. While these losses are a consequence of the distress in these companies' businesses, they have been particularly concentrated in this asset class, leaving these investors in a vulnerable position.

2. Lehman Brothers' Prime Brokerage business in London had a large allocation to the convertible arbitrage business. Hedge funds (the largest investors in this space) that held their prime broker assets at Lehman are facing the potential loss of 100% of those assets. In addition, news is coming out that Lehman may have rehypothecated those assets as collateral for funding arrangements (repos). Lehman's repo counterparties appear to have been heavily selling those portfolios in the market in the last few days in order to recover these loans.

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And most pressingly:

3. The Short Sale Order. With the initiation of the Short Sale Order, convertible arbitrage investors can no longer hedge their convertible positions by selling short stocks on the list of covered issues. With the list growing daily, and including an increasing number of firms (such as GM, Ford, IBM, and CVS) that are not primarily financial in nature, market participants have now lost confidence in their ability to buy any convertible security without facing the risk that the underlying stock may be added to the list, thereby impairing their ability to manage the hedging risk of their position.

   The exception adopted by the Commission for OTC market-makers, including derivatives market makers, falls short of addressing this problem. The primary investors in converts are bank and broker-dealer proprietary trading desks (such as our convertible arbitrage desk), and hedge funds. Because these desks generally trade strictly for their own account, and are not in the business of facilitating customer or counterparty orders, they do not qualify as market makers.

   Even in a normal liquidity environment, conventional convertible sales and trading desks that might qualify under the market maker exception would not have sufficient capital to absorb the supply that we are observing pouring into the market. In the present environment, their ability to take on these positions is woefully inadequate.

   The Order has essentially created a situation where there is no end-buyer at a time when there are forced sellers.

This market is therefore in a "perfect storm" which is getting worse by the day. Bank and broker-dealer proprietary trading desks and hedge funds are presently executing a mass liquidation of their holdings of convertible securities at increasingly distressed prices in yet another unfolding "run on the bank" scenario. This could well have the effect of forcing many hedge funds and trading desks out of business. The concomitant effects are:

1. Corporate credit spreads are widening, as investors lower their prices for other corporate bonds and bank debt as the convertibles become relatively cheaper. The IG10 index of corporate credit spreads has widened from 162 to 170 since the order was announced. This will increase fear and cause liquidity in the corporate debt market to be further reduced. This may in turn spread contagion to U.S. corporate debt more generally, and from there to other asset classes.

2. A further loss of liquidity in the repo market, as banks that are already reluctant to take credit exposure to other banks become increasingly uncertain of the value of the collateral supporting inter-bank repurchase obligations.

3. A further loss of liquidity in broad financial markets as other investors become more afraid of hedge fund liquidations.

4. Negative news headlines, further eroding confidence in our financial system, and losses to hedge fund investors that may have to be covered by selling in other non-hedge fund markets.

The ability to hedge part of the risk of convertibles allows us to invest in this debt. Without this ability, we are fearful that the market for convertible securities may follow in the footsteps of the sub-prime, CDO, and auction rate securities markets and effectively cease to function. This asset class has historically been the buyer of "second last resort" ahead of only the Federal Government, as we've seen with financial issuers in the last year.

Convertible positions held by bank and broker-dealer proprietary trading desks and hedge funds are typically only partially hedged with the underlying shares, between 25% and 100% - leaving the investor net long the shares from an economic perspective.

We also note that the call options embedded in the convertibles cause convertible arbitrageurs to be short sellers of stock in rising markets, and buyers of stock in falling markets. Removing this constituency will only increase potential volatility in these names.

We realize that looking out for the interests of proprietary trading desks and hedge funds is not a priority for regulators in the current market turmoil, nor should it be. Nevertheless, the unintended consequences of the emergency short sale rules in constraining the investment activities of these investors are having a disastrous effect on the converts market. We are concerned that these unintended effects are only beginning to be felt, but will cause an accelerating deterioration of the converts market, which will in turn quickly spread to the broader markets and serve as yet another burden on the U.S. economy generally. In this way, an emergency order restricting short sale activity that was intended to provide temporary support and stability to the market is in fact causing the opposite effect.

We therefore urge the Commission to consider:

1. An immediate revision to the Short Sale Order, putting in place an exemption for investors who are net long their economic exposure in the underlying equity via a convertible security (whether currently convertible or convertible in the future - the economic position is the same). This needs to be immediate as the consequences of continuing the current restrictions over (or near to) quarter-end will likely result in a "game-over" situation for many of these investors.

2. The Short Sale Order itself should be terminated as soon as possible. Instead, to ameliorate price pressure on distressed financial firms, we recommend that the "uptick rule" be reinstated, either for financial firms or for the market as a whole.

3. DTC settlement records are reviewed so that firms who are consistently guilty of failing to settle short sale trades are vigorously investigated for potential illegal naked short selling.

Thank you for your consideration to our observations on the mounting crisis in the converts market, and our recommendations to address these concerns. We would be pleased to discuss any of these matters further with you or your staff. Please feel free to contact us at phil.taylor@rbccm.com or scott.decanio@rbccm.com, or by telephone at 212-858-7482 or 212-858-7442, respectively.

Respectfully,

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cc: Amal Aly, Managing Director and Associate General Counsel
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List of financial company convertible securities issued since 1/1/2008

Ticker	Name	Size ($mm)
BAC	Bank Of America C	6,900
LEHM	Lehman Brothers H	6,000
WB	Wachovia Corp.	4,025
PRU	Prudential Financial	3,000
WM	Washington Mutual	3,000
AIG	American Interna	2,500
FNM	Fannie Mae	2,250
C	Citigroup	2,000
KEY	Keycorp	1,500
NCC	National City Corp.	1,437
CIT	CIT Group Inc	1,175
SLM	SLM Corp	1,150
FITB	Fifth Third Bancor	1,000
LM	Legg Mason	1,000
AMG	Affiliated Manager	900
HBAN	Huntington Bancsh	569
NDAQ	Nasdaq Stock Mar	425
MTG	MGIC Investment C	390
MF	MF Global Ltd	300
ABK	AMBAC Financial G	250
WBS	Webster Financial C	225
SIVB	SVB Financial Gr	200
EWB	East West Bancor	175
UCBH	UCBH Holdings I	135
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