The Honorable Mary Schapiro   7 April 2009
Chairman
U.S. Securities and Exchange Commission
100 F Street NE
Washington, DC 20549

Dear Chairman Schapiro:

Various industry groups and the exchanges, in anticipation of the Commission's upcoming hearing on short selling, have submitted a number of proposals to the SEC. The proposals all support the notion of ridding the market of "abusive" short selling. They then proceed to make the assumption, that unencumbered short selling is good and based on its historical existence needs to be preserved. In general, the proposals either argue (1)short selling is not the problem and nothing should be done or (2)the only problem is to figure out the right steps to accomplish getting rid of abusive short selling.

The first thing I would ask the Commission to consider as it sorts through these detailed arguments is to approach the subject with a clean slate. Question what makes short selling sacrosanct - when is it value added and when is it not? I know of no basic economic law or principle that even supports the premise. My letter is an attempt to give you a different perspective to consider on some of the arguments and issues other industry participants have put forth.

The "Modified Uptick Rule" proposed by the exchanges is consistent with meeting the objective of returning to the rules prior to the lifting of the restrictions in 2007. Requiring short sales to be entered as passive limit orders above the market is actually superior to the old rules; it solves the logistical problems associated with multiple points of execution and flickering quotes, which are caused by computer-generated orders and their attendant resolutions approaching a hundred thousand messages per second. The modified uptick rule also accomplishes one other very important thing – <u>every short sale is turned into a positive liquidity force in the market</u>. Even with the old uptick rule short sellers were rarely making a a trade that added to liquidity. The technology effort to implement the modified uptick rule should be minimal.

The second part of the exchange's proposal involves the use of a "circuit breaker". In an effort to persuade the Commission to allow unrestricted short selling in "normal" times, the proposal assumes that this unrestricted short selling adds to liquidity and promotes price discovery. The modified uptick rule would only apply when the trigger point of the circuit breaker was breeched. However, the use of a circuit breaker renders their proposed modified uptick rule virtually useless in controlling the kind of unrelenting pressure coming from short selling that we witnessed in the fall of 2008. Had this proposed combination been in place during that period, it would have just taken perhaps a few more days to get stock prices to the levels that we saw. The only positive aspect of this circuit breaker is that it will prevent short selling from driving the price of a stock to zero in the space of one day. Enumerated below are the reasons for the Commission to reject the circuit breaker concept.

1. <u>Liquidity</u> - There is never a time when hitting ever-lower bids adds to liquidity - not down 10%, 5% or any percentage below the bid. If hitting bids added liquidity, the exchanges making this proposal would have to turn their present rebate schemes upside down. Exchanges understand that providing liquidity is important and are willing to pay for it. They currently pay those who post a bid or offer because those orders are the only ones

deemed to add liquidity. They charge the short sellers hitting bids because they are taking liquidity out of the market. It is not logical to think they can have it both ways. However, the modified uptick rule without the circuit breaker would turn every short sale into the category of being a liquidity provider.

2. Price Discovery - It is generally conceded that short sellers do at times help dampen the unwarranted upside price rises by adding to the supply of available stock that long sellers aren't willing to part with even at higher prices. In these instances, short selling serves a legitimate purpose. This is on the upside and the proposed modified uptick rule does not impede that at all. However, it is a specious argument that short sellers help price discovery on the downside. How is it that huge pools of capital, utilizing computers to track thousands of 3 and 4 letter symbols, and when matched with predetermined price movement formulas, fire off thousands of orders within seconds and billions of shares in the course of a day, help the price discovery process? This trading activity comes so fast that there are times when the cancellations arrive at a point of execution before the original order to sell short has arrived. Is this some new invisible hand helping the market arrive at the correct price level?
3. Trading Range -The proposal argues that in "normal" times, unrestricted short selling is purely benign and the modified uptick rule is unnecessary. For the sake of argument and using their 10% circuit breaker example, there would be a window of time and a price level each day, that the short sellers could act with impunity until the price of the stock breeched its 10% down level. Would an investor feel better if their stock went down 50% in the space of couple of days rather than one day? Once a stock is put into play with a downward trend, the trigger point will be a self-full filling prophecy As a stock price gets ever closer to being down 10% the circuit breaker would virtually guarantee that the level would be reached because the short sellers would be competing to hit the remaining bids before the window closed. Considered from an investor's perspective, what is the point of stretching out unrelenting pressure from short selling from one day to five days or longer? It may even make the problem worse. The idea might have some legitimacy,if a "normal" range of trading could be devised for each individual stock that would trigger the "circuit breaker" but that would introduce another whole level of complications. If there was an inordinate amount of confusion over the outright prohibition of short selling in a list of 600 financial stocks this past fall, how would investors cope with all the stocks listed on the exchanges, each with a different circuit breaker. It is equally illogical and just as complicated to say all stocks have the same percentage of a normal trading range. 10% and even 5% is ridiculously high for all but a handful of securities. Therefore, what is it to be – somewhere between 1% and 3%? Whatever range picked will be arbitrary and wrong for virtually all stocks because at some point in time, trading ranges can change. It is also introducing a formula to the execution process that by definition will be an ever-changing absolute number for each stock. Without knowing the precise answer I suspect it will be a technological challenge to build; and will certainly slow down the execution process. As a last note on the trading range concept, a legitimate case can be made for unrestricted short selling for any stock that was unchanged or up on the day from the previous day's closing price. In those instances short selling, even when hitting bids, does contribute to liquidity. The modified uptick rule would then be used for all other short selling
4. Compliance - The circuit breaker concept will make compliance harder, not easier - exactly the opposite of the exchanges assertions. Determining whether a stock is subject to the modified uptick rule, with a moving trigger point is what introduces unnecessary compliance issues – both for the exchanges who will be charged with enforcing the restrictions and for the firms managing their client and proprietary activity. In addition, if the system(s) fails, there will be potentially thousands of erroneous trades. These will all have to be adjudicated in some way and the market will not be standing still while the

problem gets sorted out. This is a compliance nightmare and as is often the case, purely innocent parties turn out to be the losers in that scenario. However, unfettered by the circuit breaker, the modified uptick rule is simple. If the exchanges are capable of rejecting a short sale order when it is not above the prevailing bid and the order has been marked properly, there is nothing left to be done. All rules should be so simple for compliance officers.

Not mentioned in any of the proposals are the basic concepts of fairness and transparency. These are areas which the investing public looked to the SEC for its leadership and the items listed below are worthy of your consideration. Specifically:

1. When a long seller is attempting to sell at a given price and coincidentally is competing with a computer-generated short sale, the long seller will lose that price competition every time. All those pennies that the SEC was saving the public when it went to decimals, the public is losing dimes and quarters every time they compete with short sellers in getting to a bid. On the downside, every penny made by a short seller is nearly always at the expense of a long seller at any given price level- after all, the shorts don’t wait politely in line until all those who are long the stock go first.
2. All of the proposals cite various studies that diminish the role short selling has on the market including the Commission’s own study that led to the lifting of the restrictions. That begs the question - if there is so little of it going on why is it so important to preserve? This 1 or 2% activity is surely not the essential component in maintaining our status as the best market in the world, after all, we had the world’s best market five years ago when we had the full blown uptick rule and bid test. To clarify that issue, I would propose we find out exactly how much short selling actually exists by creating a real time short interest volume display or query. Reporting short interest every two weeks is meaningless. Even reporting short interest at the end of the day does not take into account the billions of shares shorted and covered during the day. Making short sales transparent to the market would be a positive step for several reasons. First, it would clarify for the whole market, whether selling is coming from the holders of the stock or from those making a bet that the price is going lower. Not only would this be of interest to the direct market participants but is of particular interest to the issuers, who constantly complain about short selling in their company stock. This real time display would eliminate that speculation forever. Equally important, real time short sale reporting will give the regulators a capability to help identify potential violations, such as short selling in front of bad news – as the damage and violations are occurring, not months and years after the fact. More generally, they will be able to monitor on a real time basis the significance short selling is having on a particular stock and the market overall. It certainly would have put the Commission in a position of knowing the true extent of short selling in the bank stocks before restricting short sales entirely in September 2008. For the same reason, this could also be a significant tool for the new “Systemic Risk” analysis/position proposed by President Obama’s administration.
3. I also propose that the Commission move to a T + 1 settlement date as an interim step toward same day settlement. We live in world of micro second trading and a 3-day settlement. That is inefficiency in the extreme. This change would remove additional systemic risk caused by participant failures as well as eliminate many issues that surround settlement on short sales, buy in requirements and the accompanying stock loan/borrowed machinations.

Considering all of these issues, I am concerned that adopting the proposal laid out by the exchanges with the circuit breaker triggering feature will be a compromise designed to accommodate the exchanges and at the same time satisfy the public and Congressional desire to “do something” but will be virtually useless in solving the problem. This is no time for the SEC to take partial steps. Congress, and more importantly, the investing public and the investment institutions through which they participate are looking for the protection only you can provide. Their confidence is not bolstered by preserving or protecting unrestricted trading for the special niches of hedging, arbitrage and other esoteric financially engineered products – all the so-called “low risk” trading strategies that can be traced to virtually every financial debacle in the last 30 years. Arguing that unrestricted short selling is a vital component of making the US markets the best in the world falls on deaf ears when one has just lost their retirement. Make no mistake, the public’s confidence in the equity markets has been badly damaged and returning to the uptick rule as proposed without the circuit breaker will go a long way in helping to restore that confidence.

Finally, we have witnessed in one short year the loss of trillions of dollars by investors and a near collapse of the banking system. Short selling was not the cause of the melt down of our financial markets but it did play a role in fueling price declines and contributing to a loss of confidence – and it will continue to do so in the future unless the SEC eliminates unrestricted short selling as an issue. The whole capital raising and allocation system that ultimately drives the creation of jobs in this country is at stake. Why compromise and take a half step when the potential risk is so great. In my opinion, failing to bring finality to this matter is neither in the best interest of the investing public nor the SEC itself.

I look forward to the outcome of your April 8th hearing.

Respectfully,

Glen Shipway
Public Investor

cc: The Hon. Kathleen L. Casey, Commissioner
The Hon. Elisse B. Walter, Commissioner
The Hon. Luis A. Aguilar, Commissioner
The Hon. Troy A. Paredes, Commissioner
Congressman Barney Frank, Chm-Financial Services Committee
Congressman Gary Ackerman, Financial Services Committee
Senator Theodore Kaufman
Senator John Isakson