The above-entitled matter came on for hearing, pursuant to notice, at 9:33 a.m.
CHAIRMAN SCHAPIRO: Good morning. Welcome today to day two of the Securities and Exchange Commission's Securities Lending and Short Sale Roundtable, which will focus on short sale issues.

First, on behalf of the Commission, let me thank all of you who've agreed to participate today. Our consideration of these important short selling issues will be enhanced by what I expect will be informative and interesting comments, insights, and recommendations by our panelists.

During my tenure as Chairman, the issue of short selling has been the subject of numerous inquiries, suggestions and expressions of concern to the Commission. We know that the practice of short selling evokes strong opinions from both its supporters and detractors. I have made it a priority to evaluate the issue of short selling regulation and ensure that any future policies in this area are the result of a deliberate and thoughtful process, which is why we're here today.

Today's roundtable discussion includes two panels. Each panelist will take a few minutes to share his or her thoughts on the issues being discussed, and when these introductory statements are complete, the floor will be opened to questions from the Commission.

The first panel will consider the merits of
imposing a pre-borrow or "hard locate" requirement on short
sellers, either permanently or on a pilot basis. The panel
will also consider the alternative forms that a pre-borrow or
hard locate requirement could take to enhance its
effectiveness and benefit to investors.

Among the many inquiries, suggestions, and
expressions of concern that the Commission has received
concerning short selling, and particularly "naked" short
selling, many have recommended that the Commission impose a
requirement that anyone effecting a short sale must borrow or
arrange to borrow the securities prior to effecting a short
sale.

The Commission is concerned about abusive naked
short selling and persistent fails to deliver, and the
potentially manipulative effect this activity can have on our
markets. Thus, we are examining whether a pre-borrow or hard
locate requirement or another alternative is necessary or
would be effective in addressing such activity and preventing
problems in the marketplace.

The discussion will take into account the
Commission's existing "locate" requirement under Reg SHO,
which requires broker-dealers, prior to effecting a short
sale, to borrow or arrange to borrow the securities, or have
reasonable grounds to believe that the securities can be
borrowed so they can be delivered on the delivery date.
The discussion will also consider the impact of temporary Rule 204T, and now final Rule 204, which requires clearing firms to purchase or borrow shares to close out a fail to deliver resulting from a short sale by no later than the beginning of trading on T + 4.

The second panel will consider additional measures -- additional means to foster short selling transparency so that investors and regulators have greater and more meaningful information about short sale activity.

The panel will consider enhanced disclosure methods such as adding a short sale indicator to the Tape to which transactions are reported for exchange-listed securities, or requiring public disclosure of individual large short positions.

In the fall of 2008, the Commission adopted a temporary short sale reporting rule, Rule 10a-3T. The rule required certain market participants to provide short sale and short position information to the Commission.

Instead of renewing the rule, the Commission and its staff, together with several SROs, determined to substantially increase the public availability of short sale-related information by publishing, on a daily basis, aggregate short selling volume data in each individual equity security and, on a one-month delayed basis, publishing information regarding individual short sale transactions in
all exchange-listed equity securities.

In addition, the Commission has enhanced the publication on its website of fails to deliver data so that such information is provided twice per month and provided for all equity securities, regardless of the fails level.

Today's panel discussion will consider whether additional public or non-public disclosure of short selling transactions and short positions would be beneficial, and if so, what type of disclosure should be implemented. I am also particularly interested to hear about the experiences in foreign jurisdictions, such as the United Kingdom, that have implemented short sale reporting regimes.

Today's panelists are leaders and experts in their respective fields. They represent a range of constituencies that includes issuers, financial services firms, self-regulatory organizations, foreign regulators, investors, and the academic community. It's a privilege to have them here, and we look forward to an informative and interesting discussion.

I'll be happy now to turn the meeting over to Jamie Brigagliano, Acting Co-Director of the Division of Trading and Markets, who will introduce and moderate our first panel.

Jamie.

MR. BRIGAGLIANO: Thank you, Chairman Schapiro. We will now begin the day's first panel, titled
Controls on Naked Short Selling: Examination of Pre-Borrow and Hard Locate Requirements. Following introductions, the panelists will each make a brief opening statement. Because we have a lot of information to cover in a relatively short amount of time, we ask that panelists limit their opening statements to no more than three minutes.

Following opening statements, the panel will receive questions from the Chairman and Commissioners. While responding to questions from the Chairman and Commissioners, panelists are encouraged to engage in a dialogue with one another. We welcome discussion of other panelists' viewpoints, differing opinions, and additional thoughts in response to other panelists' remarks.

Before we begin, I would like to welcome and introduce our distinguished panel.

William Conley is Managing Director of the Equities Division of Goldman Sachs.

Peter Driscoll serves as the Chairman of the Security Traders Association.

Dr. Frank Hatheway is the Chief Economist of the NASDAQ OMX Group, Inc.

William Hodash is the Managing Director for Business Development at the Depository Trust & Clearing Corporation.

Paul Lynch is Senior Managing Director and Head of
Global Trading for the Securities Finance Division of State Street Corporation.

Michael Mendelson is the Director of Global Trading Research for AQR Capital Management.

Dennis Nixon is the President and CEO of International Bank of Commerce and Chairman of International Bancshares Corporation.

William O'Brien is the Chief Executive Officer of Direct Edge, the third-largest equities marketplace in the United States.

Thomas Perna is Chief Executive Officer of Quadriserv.

Bill Conley, would you like to get us started?

MR. CONLEY: Thank you.

I'd like to start by thanking the Chairman, Commissioners, and members of the staff for the invitation to join today's panel. This panel has been asked to address topics that would likely have considerable impact on market structure, liquidity, and efficiency. We appreciate the opportunity to join the discussion.

We believe that the available evidence does not support the need for any form of pre-borrow or hard locate. The Government Accountability Office confirmed in its May 2009 Report on Regulation SHO that 99.9 percent of daily transactions in U.S. equity securities, by dollar value,
clear and settle within the standard three-day settlement period.

This data confirms that current regulations, including Rule 204 of Regulation SHO, are the most effective ways to control abusive short selling. Rule 204 requires clearance brokers to close out any delivery that does not settle in the prescribed settlement period.

In the case of short sales, the mandatory closeout period is one day after contractual settlement. Our review of CNS fail data suggests that fail rates have declined over 80 percent since the implementation of the mandatory closeout provisions.

The time and cost associated with a pre-borrow or hard locate requirement should be carefully considered if the objective is to increase timely settlement only by 0.1 percent.

Both pre-borrow and hard locate requirements will require significant expense to the industry and its participants.

At a minimum, pre-borrow requires the funding of the borrow begin on trade date instead of settlement date. In this regard, it is important to note that short sale proceeds are not available to clearance brokers until settlement date, requiring the clearance brokers to fund the pre-borrow out of their own capital.
For example, in the wake of the July 15, 2008 SEC emergency order that resulted in pre-borrows on 19 covered financial stocks, broker dealer balance sheet impacts of up to $2 billion on those securities in particular for pre-borrows were reported.

Only a small percent, estimated to be less than 5 percent, of all locates result in the need to borrow. Consequently, pre-borrows would needlessly drain supply from the securities lending market, which would result in reduced liquidity.

The costs associated with short selling will rise. Pre-borrows or other reservations of stock will result in fees being paid by borrowers to lenders, and that will be passed along to short sellers. Both a pre-borrow and hard locate requirement would require significant infrastructure builds on the part of the industry as well as its participants. For example, a hard locate concept that has been circulated would require every executing broker, clearing and prime broker, custodian, agent lender, and DTCC to build or modify systems.

A pre-borrow or hard locate requirement can be expected to have minimal impact on abusive naked short selling because an entity that engages in this activity does not comply with locate requirements, nor does it seek to make delivery when it's due. Pre-borrow and hard locates serve to
add cost and complexity that impacts those who are already complying with regulations.

The implementation of the mandatory closeout provision of Rule 204 has largely eliminated fails. That said, we recommend that the Commission move forward with the adoption of the revised prime brokerage no-action letter, which has been submitted on behalf of the industry by SIFMA.

The framework outlined in this letter provides for enhanced order marking (long versus short), customer positions to support long sales, and locates, but most importantly requires communication between prime brokers and executing brokers when certain discrepancies are detected.

In summary, Section 10 of the revised letter requires notification of order marking discrepancies (long versus short). Section 11 requires the validation of positions on long sales. Section 12 requires the prime broker to validate locates on short sales.

Any discrepancy not resolved with the customer must be reported to the executing broker. The executing broker must consider this information in determining subsequent transactions with the customer.

These procedures are specifically targeted at ferreting out anyone who attempts to engage in abusive naked short selling. Thank you.

MR. BRIGAGLIANO: Thank you, Bill.
Peter Driscoll?

MR. DRISCOLL: Good morning. My name is Peter Driscoll. I'm the current Chairman of the Security Traders Association. The STA is a professional trade organization that provides a forum for our traders to share their unique perspective on issues facing the securities markets.

Our members work together to promote investor protection and efficient, liquid markets. The STA appreciates the opportunity to share our opinions on short selling regulation in general and abusive or naked short selling in particular.

We believe that the Securities and Exchange Commission should be applauded for the development and implementation of Regulation SHO. The Commission went to great lengths through the regular notice and comment rulemaking process, and an extended pilot implementation, to ensure that all points of view and relevant facts were examined, and that the new rule was appropriate for the new market structure. We continue to believe that with some minor adjustments, Regulation SHO can effectively control abusive short selling, including naked short selling.

The STA believes that short selling is a legitimate, economically important activity that fosters price discovery and is a critical component of overall liquidity. We commend the Commission for focusing on the
balancing of costs and benefits of any additional short
selling restrictions.

We are not aware of any evidence showing that
restricting short selling would have eliminated naked or
abusive short selling, increased investor confidence, or that
the benefits of the new regulations would outweigh the
additional costs they would impose.

We believe that Rule 204 has produced empirical
evidence that the clearing and settlement function is the
appropriate area on which to concentrate short sale
restrictions. Implementation and enforcement of Rule 204 has
reduced the number of stocks on the threshold list from 582
in July of '08 to 63 issues one year later, a reduction of
89 percent.

The STA has expressed concerns about the reasonable
grounds to believe standard contained in Rule 203 of
Regulation SHO, and recommends that the SEC undertake a
review of Rule 203 and its interpretations to amend the
rule's language and address any circumvention of the intent
of the rule. Surgically altering the language and strict
enforcement could provide significant results in the effort
to control improper and abusive short selling, including
naked short selling.

If the Commission believes that additional
regulation is absolutely necessary, the Association would
suggest that the Commission review our circuit breaker
elected pre-borrow proposal sent May 4th.

While the circuit breaker pre-borrow proposal would
be a reasonable alternative to short sale price tests, it may
not be a reasonable alternative to Rules 203 and 204 in an
effort to address naked short selling. Placing a mandatory
pre-borrow requirement on hard-to-borrow issues may restrict
liquidity to an unreasonable degree and cause unwarranted
price fluctuations in the issues trading.

The cost/benefit analysis will be extremely
important when considering imposing a market-wide mandatory
pre-borrow requirement. Implementing a market-wide permanent
pre-borrow requirement would be very expensive.

As we have mentioned in previous comments, the
breadth of the abusive short sale problem appears to be
limited in nature, and a market-wide permanent solution would
be inappropriate. Thank you.

MR. BRIGAGLIANO: Thank you, Peter.

Dr. Hatheway?

DR. HATHEWAY: Thank you, Jamie.

As Chief Economist for the NASDAQ OMX Group, the
world’s largest securities market operator, I’d like to thank
you, Chairman Schapiro and Commissioners, for organizing this
roundtable on securities lending and short sales.

Issues that list their shares on our markets and
investors that risk capital there demand rules that are
soundly reasoned, clearly articulated, and rigorously
administered to create a safe, fair, transparent, and
efficient venue for securities trading.

My remarks today are similar in theme and content
to those I made at the roundtable on May 5th. First, based
on numerous studies of empirical data, the Commission has
been quite successful over time in reducing fails to deliver.
Second, the Commission achieved this success through
incremental, narrowly tailored regulatory changes.

Third, the Commission should continue to focus on
reducing fails to deliver and abusive short selling, and
continue using its proven approach, careful analysis of
empirical data followed by incremental regulatory responses.

The requirements of Rule 204T and the subsequent
Rule 204 focused on issues associated with the delivery of
borrowed shares. As we turn today to the practices involved
in the lending process and consider strengthening the locate
or creating pre-borrow requirements, it is important to know
whether there is evidence of continued abuse in the stock
loan market or if there are shortcomings in the enforcement
regime which have not been addressed by Rule 204, if that's
the case -- or, excuse me, if that is not the case, one
course for the Commission is to monitor potential loopholes
in existing regulations for signs of abusive conduct, much as
they did with fail to deliver.

Acting on the hypothetical possibility of abusive conduct and at the same time restricting beneficial liquidity oriented behavior in the market is not in the best interest of investors or listed companies. Barring reliable empirical evidence that steps taken to take have not been sufficient to prevent abuses in stock lending, we would encourage the Commission to closely monitor this area rather than taking regulatory action at this time.

Should the Commission believe, however, that there currently exists abusive conduct in the stock loan markets, we would support the Commission taking immediate and effective steps to close any existing regulatory gaps.

NASDAQ OMX Chief Executive Officer Robert Greifeld has publicly urged the Commission to consider adopting a hard locate rule.

Under current rules, securities lenders are constrained in issuing locates by the risk of a short squeeze or other events that would simultaneously force delivery of all located shares. Borrowers are similarly constrained from accepting locates from unreliable lenders. The regulations do permit, however, firms to assess that risk on a stock-by-stock basis. Therefore, there may be gaps in the current locate practices.

A hard locate rule would augment current rules and
practices by placing a fixed regulatory limit on the number of locates per share firms could issue. The limits could be fashioned in a variety of ways: a fixed ratio; dollar volume of locates issued measured against the firm's capital, a relevant indicator; or a scale based on a characteristics of the stock, the firm making the loan, or general capital market conditions.

The essential feature of any hard locate rule, however, is substituting a regulatory limit to risk-based features used by the markets today. A well-constructed locate rule would be a powerful yet flexible tool for the Commission to reduce the costs of abusive short selling, while still preserving the benefits of price discovery and liquidity made possible by prudent lending.

The Commission should also consider differential requirements for market makers. Implementing a hard locate rule or other restriction on security lending will likely increase the cost of providing liquidity. Again, the empirical evidence should dictate the exact structure of this exemption.

NASDAQ OMX stands ready to assist the Commission in analyzing appropriate and necessary steps necessary to reduce fails to deliver and abusive naked short selling. As I stated earlier, the Commission should first determine whether sufficient empirical data exists to warrant further
tightening of lending through restriction on locates.

If the Commission can make that determination,
NASDAQ believes that a hard locate rule, as described above,
would be the most effective, flexible tool to balance the
overall risk, cost, and benefits associated with short
selling. Thank you very much.

MR. BRIGAGLIANO: Thank you, Dr. Hatheway.

Bill Hodash?

MR. HODASH: Thank you, Chairman Schapiro and
Commissioners, for inviting DTCC to participate in today's
roundtable.

As part of DTCC's mission, we are closely following
discussions with regard to potential new regulations that may
affect our customers with an intention to, wherever feasible,
develop central tools that can support regulatory objectives
while helping minimize their compliance costs.

Those who believe that naked short selling is a
severe problem in the U.S. markets often cite fail to deliver
statistics as an indicator of naked short selling activity,
notwithstanding the SEC's own cautionary statements that
there can be any number of reasons for fails, and that the
existence of fails cannot automatically be construed as
evidence of naked short selling activity.

Even bearing that caution in mind, recent trends
and fails can suggest some conclusions about what's happening
in the markets. For the Commission's consideration, many in
the industry believe a measure of the efficacy of Commission
Rule 204T and Rule 204 in combating naked short selling may
be the impact it has had on fails to deliver in CNS.

Thus, a look at the fail rates over the last year
before and after the introduction of Rule 204T may be
relevant to the discussion of whether naked short selling
remains a problem. Clearly, these statistics suggest that
the regulations have had a dramatic impact.

Now, these fail statistics are not about trades.
They are about net obligations that are owed to the
clearinghouse by its members. They include both long and
short sales.

Fails during July of 2008 in CNS averaged
1.09 percent of total daily value processed. Following the
implementation of Rule 204T, fails dropped precipitously,
averaging about 0.23 percent over the last three months of
2008, and recently 0.16 percent for the month of July 2009.

Now, many in the industry feel that this low fail
rate, combined with Rule 204's requirement to close out fails
on T + 4, place appropriate back-end settlement date controls
on fails resulting from naked short selling.

DTCC's current discussions with the Commission
staff include a focus on naked short selling and the locates
rules. Omgeo, a joint venture with Thomson Reuters, has been
working with SIFMA's prime brokerage committee for several years with regard to proposed amendments to the no-action letter on prime broker arrangements, and has held out its trade suite system for use in helping to identify any remaining short selling abuses by going well beyond relying on customer representations, focusing on identifying discrepancies between executing brokers and prime brokers regarding whether a sale was short or long, inventory issues on long sales, and locate issues on short sales.

In recent discussions we've had with industry members on these and related issues, including a concept put forth by a company named Global Locate Services, that calls for a phased approach to enhancing the locate's process beginning with post-trade monitoring and reporting, there has been initial industry reaction in three areas.

Those concerns are mainly, first, that the decrease in fails calls for, at a minimum, additional time to assess whether abusive short selling is still a problem. If abusive short selling remains a problem, then work is needed to identify whether locate practices contribute significantly to it.

If this determination is reached, industry members feel that the enhanced procedures called for in the draft amended no-action letter should be implemented and monitored. Then if it's determined that there is still a residual
problem, there may be a basis for considering additional
proposals, and the industry is prepared to participate in
that analysis.

In conclusion, DTCC stands ready to assist our
customers with automated and centralized solutions that can
help them meet any new or enhanced regulations, including any
with regard to naked short selling, in a cost-effective
manner.

By the nature of our governance, we will look for
guidance from both the Commission and the industry before
embarking on the development and implementation of any such
tools.

MR. BRIGAGLIANO: Thank you, Bill.

Paul Lynch?

MR. LYNCH: Good morning. My name is Paul Lynch,
and I'm the Senior Managing Director for State Street. I'm
the Head of Global Trading and Risk Management for the Agency
Lending Business, and the Head of our Enhanced Custody
Product. I would like to thank Chairman Schapiro and the
Commissioners for inviting me here today to discuss this
important topic as financial markets continue to be shaped
for optimal efficiency and transparency.

State Street Securities Finance is opposed to the
proposal to impose new pre-borrow or hard locate requirements
in connection with short selling for equity securities. We
support regulations that contribute to a more efficient short sale marketplace, including the Commission's now permanent Rule 204 of Regulation SHO.

We agree with the Commission's analysis that Rule 204 has been -- had a positive impact. It has addressed the issue of naked short selling while preserving legitimate short selling activity. Given the success, we believe imposing additional pre-borrow or hard locate requirements is unnecessary. It will reduce the efficiency of short sales and have a number of unintended results.

Since asset managers are constantly adapting to changing economic environments and markets, a pre-borrow regulation in practice leads to multiple pre-borrows for every eventual short sale due to the many locates never materializing in a short sale.

Any type of pre-borrow activity that would encumber my clients' assets would require a form of borrowing fee for my client, whether or not a physical delivery was made. The result would be unnecessary utilization of inventory and increased fees from borrowers. Short-term, this would be beneficial to my firm and my clients. But long-term market consequences made adverse to all.

The long-term increased borrowing costs, the potential increased prime brokerage capital usage, the securities lending inventory illiquidity resulting from a
pre-borrow or hard locate requirement, could lead to a number
of detrimental consequences for a legitimate short sale
activity. As legitimate hedges and short sale strategies are
restricted, market volatility will increase.

In summary, we believe a pre-borrow requirement
could expose the market to detrimental consequences and
provide no demonstrable improvement in market efficiency or a
measurable impact on naked short selling beyond the
Commission's existing policies and regulations. Thank you.

MR. BRIGAGLIANO: Thank you, Paul.

Michael Mendelson?

MR. MENDELSON: Chairman Schapiro, Commissioners,
and staff, thank you for inviting me to appear before you.
I'm a principal at AQR Capital Management, an investment
management firm that manages assets for, among other, pension
funds, endowments, and foundations.

Short selling is an important activity with many
benefits. But a tiny portion of short selling is abusive
naked short selling, a practice we oppose. Regulation of it
should seek to maximize the benefit of constructive short
selling while mitigating the problems associated with both
benign failures to deliver and illegal manipulation. It
should not ensnare the vast majority of short selling
activity, for that will prove costly to legitimate investors,
possibly without having any effect on the problems we are
trying to solve.

I had planned to promote the success of Rule 204, but at this point that would just be piling on. Rule 204 is well-targeted. Pre-borrow and hard locate proposals are unguided.

Pre-borrow requirements are ineffective and very costly. They will have little effect on someone who isn't bothering to get a locate now, and will require clearing brokers to forward cash collateral to lenders three business days before the proceeds from any short sale are available. This is an excessively expensive requirement whose costs will be paid by investors in the form of higher fees, increased trading costs, reduced prime brokerage competition, and greater market inefficiency.

Hard locate requirements are ineffective and excessively burdensome to investors. They do not suffer from the substantial funding problem of pre-borrow, but still force dramatic costs on the stock loan market that are not offset by gains in compliance or, I believe, improved investor confidence.

Hard locate requirements won't deter naked short sellers. They don't comply with locate rules. It will not accomplish the goal of eliminating fails since we cannot prevent the actual owner of the long security from selling; it will turn an automated, auditable process into a
cumbersome and costly function; it will substantially impair liquidity providers, and will create an economic value to locates where little or none has existed to date, leading to hoarding, additional costs to investors, and the potential for new manipulative practices. These same concerns apply to pre-borrow, too.

While I do not support pre-borrow or hard locates, the system can be improved. The Commission may wish to consider:

(1) Requiring clearing and executing brokers to conduct daily reconciliations of locates, including verification that locates were obtained before the time of sale and that sale orders were properly marked as long or short;

(2) Requiring executing brokers to determine which of their clients show a pattern or a practice of failing to deliver securities; and

(3) Requiring that short sellers employing exemptions from locate rules mark their orders with the specific type of locate exemption under which the stock is traded, and examine whether short sellers employing exemptions for the locate rules are using those exemptions for their intended purposes.

It is possible that many of the non-operational failures to deliver we see today are failures of this type.
For those interested, I have provided further detail in my written statement. Thank you.

MR. BRIGAGLIANO: Thank you, Michael.

Dennis Nixon.

MR. NIXON: Good morning. I'm Dennis Nixon, President of International Bancshares Corporation. And I thank the Commission for the opportunity to participate today.

To respond directly to the topic of this panel, IBC firmly believes that short traders should be required to pre-borrow shares before engaging in a short trade, and should have parallel disclosure obligations to long traders.

IBC has spent the last six months with a team of professionals educating, investigating, and taking action to prevent what appears to be manipulative short selling of IBC stock.

IBC has met personally with the Commission, ABA, FINRA, NASDAQ, and several members of Congress to explain the negative effect short sellers have on financial institutions.

Additionally, IBC submitted a 22-page comment letter dated June 9, 2009 on reinstating the uptick rule, which called for the Commission to vigorously enforce current short selling rules, institute a pre-borrow requirement for short sale transactions, promulgate disclosure rules for short sellers which mirror those obligations for long
positions, investigate the impact of the market maker exemption, and promulgate rules which would require brokers to allocate lent stocks and disclose the margin account -- to the margin account holder of the loss of voting for those shares.

In a supplemental comment letter dated June 17, 2009, IBC urged the Commission to promulgate rules to address the lack of reporting and transparency in which short sellers operate. IBC has also submitted letters to bank regulators requesting their investigation into how short sellers may be violating certain banking laws.

All these efforts involve substantial expense of both time and money in an effort to better protect our shareholders, depositors, and the communities we serve. IBC is a well-capitalized $11.4 billion multi-bank holding company headquartered in Laredo, Texas, serving 104 communities in Texas and Oklahoma, and is traded on NASDAQ under the ticker symbol IBOC.

IBC is an award-winning bank and has been rated as one of the best performers among its peers. We have a record of over 136 consecutive quarters of continuous profitability. Having experienced economic downturns in the past, we expected an impact to our stock price, given the financial crisis. However, none of us expected that short sellers would be able to severely detach IBC's fundamental value from
its trading price.

Since the beginning of the year, IBC's short volume has increased to a record -- to a level of over 11 million shares, an increase of 891 percent. At its peak, short sellers represented over 21 percent of IBC's generally accepted float, and drove IBC's stock price from over $24 to a low of $6.55 in a matter of months.

We have provided two charts in our written statement filed with the Commission which show the dramatic impact that short sellers have had on IBC. IBC believes short sellers provide little value to the market outside of legitimate market-making activities.

The current rules allow for naked short selling of stock within the three-day window, but only classify the trade as naked once there is a failure to deliver. IBC believes a true naked short position is created when a short seller sells a stock without first borrowing the security. We have yet to be convinced why the current three-day delivery time should be allowed.

I want to thank you, and I look forward to discussing these issues with you today.

MR. BRIGAGLIANO: Thank you, Dennis.

Bill O'Brien.

MR. O'BRIEN: Good morning. I'd like to thank both the Commission and the staff for the opportunity today to
participate on behalf of Direct Edge, the nation's third
largest stock market.

The Commission's targeting of naked short selling
through the passage of stringent locate, borrow, and delivery
requirements, such as Rule 204, have yielded impressive
results to date by drastically reducing the incidents of
failures to deliver, the data points of which I won't restate
here. But the data clearly suggest the actions that the
Commission has taken to date are working very well to curtail
truly naked short selling.

Thus, at this juncture, the Commission's focus
should be on what measures would be cost-effective in further
curtailing abuse, while making the process of short sale
delivery and settlement more efficient, and leveraging these
efforts to rationalize the regulatory framework surrounding
short sales generally.

Our belief is that imposing a pre-borrow
requirement for short sales would constitute an inefficient
use of capital, as such a requirement would need to be funded
by prime and clearing brokers and would force securities to
be locked up in a customer's account for the three days
preceding settlement.

On the other hand, we believe that an examination
of potential cost-effective improvements to the locate
process are warranted, particularly if they can mitigate some
of the inefficiencies that exist in the current regulatory
structure governing locates and improve coordination between
custodians, executing brokers, market centers, and
regulators.

Today, when a customer executes a short sale and
custodies their assets at the same broker, whether it be a
retail investor or an institution with the prime broker,
generally the custodian will decrement shares available for
lending thereafter on a real time basis as part of the short
sale execution process. In such a scenario, a reliable hard
locate is effectively obtained.

The challenge in broader mandates for hard locates
would appear to be in achieving the same level of reliability
for away locates, where the custodial and the executing
broker are different, and provide similar certainty for
actual delivery on a cost-effective basis.

Reliability could be enhanced by improving trade
date validation for locates through end-of-day
reconciliations between the locate broker and the executing
broker. Such an approach potentially enhances the
reliability of away locates, exposes naked short sellers, and
facilitates inventory management of securities available for
loan.

Initiatives and processes to facilitate this
warrant further examination and support both with respect to
their efficacy and potential for expansion, such as the revised prime broker no-action letter.

Greater transparency for borrowing and lending transactions with proper audit and compliance standards also offer potential benefits of enhanced reliability. Further, such market developments can create an opportunity for integration of securities lending activity into the transaction process itself, alleviating systemic and regulatory risk.

Any regulatory initiatives, especially mandates, must heavily weigh their resultant costs. If properly constructed, regulation can make markets more efficient and allow for rationalization of certain short sale regulation. Any further regulation of the locate process needs to consider that current short sale regulation prompts over-location, that is, locating more shares than a market participant actually intends to short on a net basis.

Any inventory management efforts grounded in locates run the risk of restricting the availability and cost of locates, potentially disrupting even net long or market neutral trading strategies. Thus, any consideration of more stringent regulation will also need to consider how to alleviate some of the regulatory inefficiencies that will only be exacerbated by a closer correlation of located shares to shares sold short.
One potential tandem effort would be the extension of the buy-to-cover concept to all securities. Currently, Regulation SHO guidance requires a locate for each short sale of a hard-to-borrow security regardless of whether a market participant has covered such shares to repurchase between such shares on an intra day basis. That standard doesn't apply to easy-to-borrow securities.

In such a situation where a locate can be directly tied to actual shares used for delivery, there should be no distinction between hard-to-borrow and easy-to-borrow securities as the locate effectively assures to ensure delivery, regardless.

Additional further efforts to minimize the need for market participants to locate more securities than they actually will need to deliver for settlement, such as a broad reevaluation and potential expansion of the role of the market maker or similar exemptions in today's market structure, should also be examined.

There are many other markets where short sale regulation is based on net economic position as opposed to on a transaction-by-transaction basis, focusing on the sequencing of transactions.

With securities lending and short sale regulation coordinated more in this fashion, the likelihood of investor benefit from greater confidence and the more efficient market
will be optimized.

Once again, I'd like to thank the Commission for the opportunity, and I look forward to any questions.

MR. BRIGAGLIANO: Thank you, Bill.

Thomas Perna.

MR. PERNA: I'd like to thank the Commission for the opportunity to appear here today. Quadriserv is happy, I think, to have been included in the Commission's review of the securities lending process.

Our company holds a strong view on the need to continue to improve transparency and make settlement more efficient in the securities lending market. As we've seen with Rule 204, pursuit of this objective should involve targeted regulatory improvements and market-based solutions that enhance transparency and efficiency. We have and will continue to support efforts that advance those important objectives.

Those responsible for implementing any proposals certainly would face challenges that should be carefully considered. However, many participants in the securities lending process have expressed a desire to move beyond the reasonable determination locate structure.

The mandatory pre-borrow requirement, although having a benefit of zero sum inventory accounting between shares located and shares borrowed is balance sheet intensive
and would significantly raise the net cost of borrowing stock. We believe that the unintended consequences brought on by these additional costs would certainly far outweigh the benefits.

In the interest, though, of evolving towards the most efficient, reliable market possible, we hope to see a middle ground. We believe that a logical middle ground could be developed. We could develop an auditable capital operationally efficient marketplace for locate supply and demand to interact.

We believe there are technological and operational frameworks that exist and can be further developed to achieve that objective. A centralized settlement or inventory accounting system could serve to further reduce settlement friction and contribute towards the industry's collective goal of making markets more efficient for investors.

With that said, we're very cognizant of the complex challenges that face the broker dealer community, in particular with many of the proposed hard locate proposal standards. With the adoption of Rule 204 as a guiding indicator of success, we're confident in the industry's ability to arrive at a compromise solution that works for those on both sides of the debate.

If a common belief emerges on the need for incremental steps to be taken to address the last mile
challenges of settlement date efficiency in the market, those steps should allow for the supply and the demand dynamics of a market where there is both a cost and a benefit to satisfying locate requirements, and something that's easily auditable.

This would allow for a market-based resolution to a challenge where there are incentives for participants to participate in a solution. Thank you.

MR. BRIGAGLIANO: Thank you, Tom, and thank you, all the panelists, for your thoughtful statements.

Are there questions from the Chairman or Commissioners?

CHAIRMAN SCHAPIRO: Thanks, Jamie. I have a couple that I could start us off with.

I'm interested -- I think Bill and Michael had a number of suggestions for improving the existing locate rule. I wondered if others of you had further thoughts on that -- I guess something short of a hard locate, but tweaks to the existing rule that would improve it.

And I guess let me add to that. I'd also love to know, as a second matter, what are the differences in costs between the current locate rule, if everybody's following it, and a hard locate rule? Is there really a significant increase in costs if we go to a hard locate?

MR. DRISCOLL: Well, the STA has mentioned several
times already that we have concerns about the reasonable
standard in Rule 203, and we think that that needs to be
tightened up.

We also have concerns whether the industry is
complying with the requirement to locate whether or not
you're going to cover that short within the same day. We
think that those two areas could bring some considerable
improvement in the way the locate rule works now.

MR. MENDELSON: I would also like to say that I've
heard many different hard locate proposals. There are some
that are used in Hong Kong. There's a proposal that's
floated around the industry a little bit that I think has not
been very well received. There's a few other proposals in
between.

And I think the cost is -- I think the cost is
pretty high for all of them to investors, but it does vary.
Proposals that -- you know, there was one particular proposal
that is a little bit of a Rube Goldberg device, where we end
up having to make so many different steps of communication
before doing a trade, after doing a trade, that it would
really throw a lot of sand in the gears of trading.

I think that there are other proposals that are
much less onerous. They still, I think, have some basic
economic problems. But the costs do vary quite a bit.

CHAIRMAN SCHAPIRO: Are the costs -- this is an
industry that is so talented when it comes to technology, and so creative and so capable of solving problems with technology. So are the costs in the creating the solution to have a hard locate, or are the costs in having a hard locate, period?

MR. MENDELSON: I think there are a lot of the costs that are just about having a hard locate that are economic. I think there are other parts that are technology, and that yeah, you know, with some expense, the industry can find a way to evolve, although it will have an effect.

There is not going to be a low latency way of communicating between all these different organizations that will satisfy all the liquidity demands of the market. Nevertheless, irrespective of those costs, if we faced all those costs, there are still going to be costs to our investors in the form of additional costs of short selling; and as a long -- in our purchases of stock, it will also cost us more because market-making activity will decline.

MR. LYNCH: I think part of the answer is how perfected do you want the hard locate to be? So at a general high level, obviously there will be a cost of technology and all of the documentation and administration around the hard locate.

But then if you want an extremely perfected hard locate, so much so that you're actually encumbering shares
somewhere for that hard locate, well, then, there's going to be an actual cost of encumbering those shares.

Whether you call it all the way to the point of a pre-borrow and a physical delivery, or whether you just call it that shares are set aside within the prime broker or set aside within an agent lender for the potential for that short sale to go through, well, there's going to be a cost with encumbering those shares.

COMMISSIONER WALTER: But isn't part of the problem today -- let me pick up on cost. Isn't part of the problem today -- the way it works is statistical, and yet there's no cost to developing, at least theoretically, a reasonable ground to believe that you can locate the shares.

There are no dollars that change hands, which gives a perverse incentive to go out there and cover whatever your potential activity might be, which undermines the statistical analysis.

So I'm sort of surprised that the industry hasn't come up with a solution, particularly as this controversy has continued to swirl and does not go away, that realigns by imposing a cost on locates, at least for hard-to-borrow securities, that would keep that from happening.

And I would add to that that the fact that there isn't a cost transfers the cost, in effect, to our enforcement program and leaves us with a problem in terms of
trying to determine whether people in fact have reasonable
grounds to believe that they can locate the securities, which
is a very difficult case to bring, and is not the place where
you want the cost to be.

So I'd love to get your reactions to that.

MR. DRISCOLE: Well, we certainly believe that
there has to be some rationalization of the shares located
with the shares available. How that's done, it could get a
little tricky. But somewhere along the line, the practice of
going out in the morning and trying to borrow a million
shares of every S&P 500 stock -- somewhere along the line,
that stuff has end.

COMMISSIONER WALTER: And so what's the way to do
it, as a pragmatic matter that works? I mean, might it be
possible, for example, to use the fail list, and as soon as a
security, for example, appears on that, to impose a hard
locate requirement then?

You know, the industry has been grappling with this
for a long time and doesn't want regulation. Yet I don't
think we've seen any movement to really cure this problem.
And there isn't anything to stop everybody from going out and
borrowing a million shares of the entire, you know, Russell
3000 every morning.

MR. DRISCOLE: We did suggest that the circuit
breaker hard borrow would work along that line. We think it
would be effective and targeted, and we would go along with a proposal like that.

MR. CONLEY: Well, I'd just add a couple of comments to that. The first thing is a hard locate is not a guarantee of delivery. We should really delineate the two of these because if we go to a bank, in this case State Street since they're on the panel, and say, we'd like to get a hard locate on this security, their client can still sell the security.

So the hard locates are done on trade date. Their client can sell on trade date simultaneously, which will be reported to them in the evening on trade date. That stock will be delivered for the client's sale rather than lent to the prime broker or short seller for delivery.

So I think, as we're contemplating this, that's just a fundamental tenet that we need to understand. And if we do restrict or encumber those shares, essentially what we're telling the investors is they can't sell those shares going forward because those are secured for a securities loan transaction. And I don't think that the Commission would want to -- would want to go down that line as well.

COMMISSIONER WALTER: But there's a difference, I think, between taking the risk that the shares will be sold and taking the risk that those same shares, in effect, have been located by, you know, a hundred different people. And I
think focusing on the sale risk is only a minor part of the
issue. And maybe that's a risk that we ought to be willing
to live with, but not the other.

MR. O'BRIEN: I think you have to recognize that
only does the reasonable grounds standard, you know, prompt
over-location. But a lot of other aspects of short sale
regulation do, you know, as well.

I mean, even, you know, the recent change to FAQ
2.5 where, you know, all sale orders have to be marked short,
assuming that they're all going to be executed, but
outstanding buy orders at the same time don't -- there's a
lot of aspects of current regulation that prompt market
participants that are not really true short sellers in the
fundamental economic sense to have to locate a lot of stock.

And I think it's a question of mandates, too,
versus motivation. There may be products out there where you
can, you know, tie back the shares more effectively. And
maybe there's disparate regulatory treatment under the short
sale rules to prompt that.

And then people can make their own economic
decision of whether that transaction flexibility, you know,
warrants the economic cost of using a hard locate or similar
system.

COMMISSIONER WALTER: But what if -- can I come
back to my initial thought and get a reaction to that, which
is, what if there were a cost imposed on the location
process? How would that -- how would you think that that
would change behavior?

MR. MENDELSON: Well, I think we should start by
thinking about why do we over-locate, which is a concern you
have. We over-locate because when we have to do the locates,
we don't know what we're actually going to short that day.
So all of us, speaking for my firm as well as other large
investors, we may at the beginning of the day say, well, I
don't know how much Exxon we may short today, but it might be
as many as 50,000 shares, so I'll locate 50,000 shares.
We won't, for sure, all of us, sell short the
maximum we could. We have that locate request out there
because the market opportunity may exist for us to short sell
those securities. It won't exist if everyone else who's
over-located the stock has sold short that stock.

And so the result is that the statistical issue
which you raise -- and you're right, the system does work
today on a statistical basis -- that there is such a low
probability that those locates that the prime brokers give us
will not in fact be delivered on.

COMMISSIONER WALTER: Understood. But I'm trying
to change the scenario for you and say, if there were a fee
charged, and not an outrageous fee, a fee charged for the
location process, how would people's behavior change?
MR. MENDELSON: Well, you would locate less for sure. Okay. I mean, that would be the obvious result of it. But I think what would happen is you would impose a cost on investors that would really end up impairing liquidity. All you would be doing is -- right now we have a system that does work pretty well for this. We have suggested some improvements to it, but it works pretty well. You'll start imposing additional new costs on our investors that will widen bid/ask spreads. It'll be the first thing you'll see.

DR. HATHEWAY: Let me take a different tack a little bit on Mike's answer, if I can. We don't know who the sort of marginal user of a locate is right now because there's no price. It might be a liquidity provider. It might be an arbitrageur. It might be someone taking a large, speculative short position, or even launching an abusive attack on a company. My guess is it's not that last guy. So unless we can put -- somehow figure out who should pay what price, putting a constant price on a locate is going to be a very difficult thing to do. And frankly, it may create, even within a subset of the community -- say, the liquidity providers -- it may create advantages for large firms who can or will locate in scale and use the locate to the detriment of smaller firms,
or some other dimension of it. One size fits all pricing, I think as you understand, would be a challenge.

MR. LYNCH: I'd like to go back to your initial point, which was that if you targeted the 0.1 percent fail list and then you strategically placed that list within a potential structure, whether that's a pre-borrow or a hard locate, that's a much more strategic regulation to find where the potential abuse is, as opposed to put it across the entire industry.

MR. HODASH: Could I have one point of clarification? The hard locate proposals, I think the questioning has uncovered there is no single hard locate proposal; that perhaps transparency into the process and understanding which securities, which market segments, are over-locating, if it's happening, might be a prudent first step.

So even in discussing that, the hard locate proposal that we've been discussing with clients, there are costs associated with that. But there's less of a latency issue involved in post-trade transparency reporting type solutions in order to understand what's going on, and sometimes that changes behavior itself.

That said, there's still technical issues with that concept as well.

MR. CONLEY: I think, ultimately, the objective
here is to reduce down fails and eliminate abusive short
selling. And I think the way that you do thought is you link
the order marking and communication between the client, prime
broker, and the executing broker.

And the executing broker is then mandated to use
any information of discrepancy, contemplating forward trades
with customers. I think that's really connecting the circle
of all the different parties in these transactions. I think
that's really the solution.

And then potentially with some regulatory output of
the discrepancies that aren't resolved between prime broker
and customer, I think it will give the regulatory authorities
clear visibility on if people are circumventing the locate
rules.

MR. NIXON: Yes. Just to comment, I think, you
know, from the Main Street side of this, I think there's a
lot more involved here than just this locate rule because I
believe this whole side of the market, frankly, is out of
balance.

And we've seen a tremendous damage to our company
of 30 years of productive work being fundamentally destroyed
by a predator practice that came against us in a bear market,
when all financial institutions are in chaos, you know. And
for somebody in our case to be able to go out and issue
11 million new shares of our stock without any kind of
registration process or any kind of formal process is just unbelievable to us.

And on the long side of the market, when you're going to -- if John Doe America wants to sell a share of stock, he's got to put it in his broker's account. He's got to go through the process to put it in a nominee name before anybody will even accept the sale of that stock.

So it seems somewhat ridiculous to me that we're talking about the short guy who can, just like a cowboy here, go do anything he wants to; but on the long side of the market, you have all this extreme restrictions. And it puts us at a disadvantage on the long side because we're trying to build an investment here.

Are we worried about the short sellers or are we worried about the investment community? And Mr. and Mrs. Mainstream America, in my view, is being abused. We lost $1,200,000,000 worth of value in our company in about 45 days.

And I think it was all attributed to this predator-type short selling that goes on in this market today that's uncontrolled. It's unbelievable. And if you live through this in a mainstream fashion, then you understand this.

We're talking about a bunch of guys here making money off of Main Street. We're transferring -- we transferred that $1.2 billion from Main Street to Wall
Street. And it doesn't seem anybody's concerned about it. And I think that's what the Commission should be concerned about. How do we protect Mom and Pop Investor out there versus enabling a bunch of guys who are really speculating on the demise of companies, not the growth of companies?

MR. DRISCOLL: While I have great sympathy for the predicament of certain stocks that are targeted, I think that you have to remember that the vast majority of short sellers are legitimate people using hedge positions.

I think that you have to target the unacceptable behavior, root out the manipulation, and go after that. You can't just expel the whole class because of one disruptive student.

MR. HODASH: And to stay on your question, Commissioner Walter, $1.2 billion on the table, you can't price a locate high enough. So we're really looking at another type of solution, either a transparency one that facilitates the enforcement process, or a different mechanism other than sort of the price mechanism for either the locate or the pre-borrow.

Because if you're focusing on a concentrated attack on the company and the costs, the price of doing it, is based on sort of the average price of a short sale across the market, you've got a big disconnect between what you intend to gain from an abusive attack and what it's going to cost
you to do it in a locate or a pre-borrow.

COMMISSIONER WALTER: The other thing that we potentially could do is to put harder edges around the reasonable belief requirement, and put more objective edges. Now, there are going to be costs to that as well. But when you've got a standard like that, you have to expect that the enforcement efforts are going to be difficult.

MR. O'BRIEN: And I think you go back to validation as well because unlike a regular transaction, where the broker that's executing it and the broker that actually is going to make delivery and settlement are the same in a short transaction where there's an away locate, you have the possibility for the left hand not to know what the right hand is doing in terms of what's the reasonable grounds for an executing broker to say that they've made that determination that effectively, the prime or other custodial broker is going to ultimately have to back up, you know, with settlement.

And so the validation point, I think, echoes true, and having a regulatory output to that to make the cost of enforcement, you know, much more -- much more efficient, potentially.

MR. BRIGAGLIANO: I'd like to jump in here on the issue of away locates because I think there is an important point. Currently, the broker does have the requirement to
locate, but the broker may also rely on an assurance from a
customer. And that customer is not necessarily a regulated
entity.

So I'd like to get the panelists' reaction to this
situation, the costs and benefits of continuing with the
broker dealer requirement to do the locate, but not allowing
the broker to rely on a customer and putting it all on the
broker, so to speak.

MR. DRISCOLL: Well, that interpretation came from
a footnote in a Frequently Asked Question release. And we
have great problems with the broker dealer being allowed to
rely on his customer, especially the unregulated entity.

It seems that as the hedge fund community has
grown, they've become a huge part of the revenue stream that
a broker dealer gets. And we kind of believe that the broker
dealer would be very readily acceptable to any offer of
assurance that the hedge fund would give them. We don't
think that that's a reasonable standard.

MR. PERNA: You know, I think, going back to some
of the earlier comments, I think, you know, we believe that,
you know, there can be a market, a central market; whereas I
think I said in my opening comments the locate requirements
and locate shares could meet.

I think, you know, the pool, a centralized pool, I
think would deal with some of the issues around customers
pulling back, between trade date and a settlement date, those shares. There could be -- there certainly would be a minimal, you know, cost, you know, imposed there during that time, which certainly could, you know, inure to the benefit of the beneficial owner of the shares.

But I think that's certainly, you know, one listing to all the issues, which certainly are true. I think that central pool of available locate shares, you know, I think is something that certainly should be considered, and I think is doable.

MR. CONLEY: While we talked about Rule 204 several times in the beginning, I'd just like to reemphasize the policing nature of this because if somebody -- if a customer, you know, misrepresents a locate, for example, the trade is going to get closed out on trade date plus four.

So after settlement date, the trade will fail, and then the trade will be closed out through the buy-in process. So the rulemaking, as it stands currently, protects against abusive behavior in that particular sort.

And one other comment on the statistical nature of the locates, referencing back to 204. If you are wrong on the locate, you will get closed out. And that's a painful experience, to get forcibly closed out of a position.

So I think that most professional players in the market, as well as the prime brokers, are very cautious about
how they're locating inventory. You know, we go through
great lengths to collect lots of different inventory feeds
from lenders in the market and haircut those through
statistical provisions to understand what we believe is the
reliable nature of that because if we're wrong, we forcibly
have to close out our customer.

MR. BRIGAGLIANO: Bill, I'd like to follow up a
little bit because there's a point that Dennis raised that
others occasionally raise, and I think it's worth bringing to
the panel's attention.

204, as has been noted, has had dramatic results in
reducing fails. But some say that even though the broker has
to close out, you know, on T4, that still allows a window for
a customer to, you know, commit naked short selling.

I'd like your reaction to that.

MR. CONLEY: I think my reaction is -- back to my
earlier comments about moving forward with the prime
brokerage no-action letter because that effectively connects
the prime broker, customer, and executing broker on trade
date plus one. That to me seems like the most rational way
to control for behavior and to eliminate any type of
activity, taking advantage of the normal settlements, like on
the United States right now.

Short of that, I mean, I don't think the Commission
is prepared to do this, but to consider changing the
settlement period, the standard settlement period, for short
sales versus long sales. I know there's been a lot of
historical work looking at shortening settlement cycles in
the U.S., and I don't think that that's an issue on the table
today.

COMMISSIONER PAREDES: If we can take just a little
bit of a step back. We're talking a lot -- and I think
appropriately so, and the discussion is fascinating -- about
solutions. But just to take a step back to make sure we're
all on the same page, or at least get the sense of folks, as
to the problem.

And there I guess my specific question is: When
you think about fails, to help us better understand from you
perspective, what are the potential causes of a fail? And so
often we're talking about naked short selling. We're talking
about the failure to deliver. We're talking about abuses.
We're talking about manipulation. And yet there may be
reasons other than manipulation, that there is, in fact, a
fail.

And without assessing that and trying to dissect
the potential causes in a little more refined way, we may get
off course in terms of some of the suggested solutions.

So I'll start with Bill, and Bill, to give a couple
of different perspectives -- but we'd be delighted to hear
from folks along the way on their thoughts.
MR. CONLEY: Thank you. You're absolutely right. I think we are focusing a lot on manipulative activity here and not looking at the broad basket.

Our most recent review of fail data shows that, I think, more 50 percent of the fails are ETFs right now, which are broad baskets of securities. And we believe that that's a functional result of the latency between the create and redeem process, between the issuers and the underlying baskets.

Additionally, a large percent of the fails currently in the market are penny stocks, so positions less than a dollar. And there are issues -- I can refer to Bill Hodash on this -- but some securities get chilled and just don't move through the security system. So if they're in transit during the chilling process, they're not going to move.

So I think if we were to undertake some effort from this meeting today, I think one of the things would be to understand and make public what really are the issues that are failing. And I know that you're doing this on the website, and we pull the information down and look at it.

But I do think that investors will find that it's ETFs and a lot of penny stocks are really the two themes that we've observed there.

MR. DRISCOLL: When I did do my analysis of the
63 stocks that I mentioned that were on a threshold list, the day that I looked at it, five of them were actual operating companies, and the other 58 were ETFs.

COMMISSIONER WALTER: Do people have any suggestion, given the prevalence of ETFs on the fail list, as to what could be done to eliminate or at least minimize that problem? Because I think we would all agree that the optimal result is for the fail list to have nothing on it.

Now, that may be an impossible dream, but we ought to try to get as close as we can. And given the structural difference with ETFs, is there a different way to approach them? Do we need a targeted solution?

CHAIRMAN SCHAPIRO: And can I add a question to that, given that penny stocks seem to be the other prevalent presence on the fail-to-deliver list? Is there any reason to think about them differently and to have a different set of requirements around penny stock locate or pre-borrow, as opposed to companies over a certain size?

MR. HODASH: Since nobody's jumped on the two recent questions, I'm going to go back to Commissioner Walter's.

Fails are an issue. Large short positions, particularly when the short position is of a magnitude that can't readily be explained by the shares that are available to lend, are a problem that we hear from our issuers, and I'm
sure other exchanges do likewise.

   While I've never had anyone on the regulatory side, either of the Commission or Commission staff or FINRA, say they can't bring an enforcement action, I have heard people say that it is difficult to bring enforcement actions around short selling, around locate, around the rules that predated 204.

   I haven't had a conversation since 204, but given the arguments I heard, I would suspect that it's the same today. And I think one avenue for the Commission to pursue is improving the audit trail and the paper trail around the short selling process so when we have a short position that it's hard to understand and it's hard to understand how fails are avoided, there's a better documentation on, frankly, how the short sales were accomplished.

   MR. LYNCH: I think the two characteristics of those two types of securities, the penny stocks and the ETFs, that are -- that kind of tie it together is both of those types of securities in the long-only beneficial owners portfolio are something that are actively traded in and out of.

   So if you're in penny stocks, there's a good chance that you're potentially liquidating at some point in time. Something brought it to that point. If you're -- if you're sitting in ETFs, you're getting in and out of that exposure,
from a basket perspective, at the client level.

So that creates a lot of volatility to the prime broker as of what supply is there on a day-to-day basis to cover the shorts. And that volatility potentially puts you into a fail situation at times.

MR. HODASH: Just one clarification on the ETFs. The figure is -- in July 2009, it was about 43 percent of the fails that I reported were in ETFs. And though I don't have the figure precisely a year before, although I cited statistics to show that the overall fail rate dropped precipitously during that period, the proportion of fails in July 2008 that were ETFs were smaller.

So there may be, to your point about studying the redemption, the create redemption process, something structural to be looked at because they did not drop by near the same amount as the non-ETFs dropped in that time.

COMMISSIONER WALTER: Does it also suggest that the statistical analysis that is engaged in in the marketplace for those two types of securities needs to be re-looked at? Since there is a tilt in that direction and it happens that much more often, if we all agree that that result is not what we want, perhaps the statistical analysis needs to be tightened up.

MR. MENDELSON: Well, it may be possible that the rise in the share of ETF fails is because of the decrease of
COMMISSIONER WALTER: Oh, it clearly is. But we're -- I mean, at least in part that's what it is. But nonetheless, if you'll assume with me for a moment -- and maybe you don't agree with this, which you should feel free to state as well -- that having the number of ETFs and penny stocks on this list that we do is not what we want, and given the prevalence, it suggests to me that the statistical analysis is working better for other types of stocks than for this.

MR. MENDELSON: Well, I think, at least in my, you know, discussions I've had over time with participants in this market, I think one of the surprising things is that the understanding of the source of the fails is not as good as you would expect.

And so in understanding, let's say, the problem with ETFs, chilled stocks, other, you know, real operating companies, of which there are really only a few on the list, and to understand why some operating customers are persistently on the list and some only pop up occasionally, I think we really need to have a better understanding of this.

Because I think one of the reasons that we're all here today is because of fears that certain people have -- I do not share those fears, but fears that some people have. They look at a list, and without dissecting what the source
of those fails are, they attribute it to behavior that is probably not in fact happening. Okay?

And I think if we better understood the sources of those fails through additional requirements on the executing and prime brokers, or executing and clearing brokers, to gather the data and examine statistically the source of the fails, I think that we would have a much better understanding of the problem.

COMMISSIONER WALTER: Do people in today's marketplace take into account the nature of the person, the identity of the person, who is asking for the locate? I mean, is that part of the analysis?

If you've been doing business with somebody who persistently, you know, never sells short after the locate, does that -- I would assume that, again, given the last of cost, there's no reason for anybody to take that into account.

MR. CONLEY: The overriding factor on locates is a function of availability. I think it's less a function of customer behavior, and really our ability to be able to deliver the stock at the point of delivery.

MR. NIXON: Can I make one additional comment? Listening to all these experts on Wall Street, I still don't understand why the short side of the market is allowed to issue shares at random, at will, at whim, without any kind of
registration restrictions at all.

In my case, in our company, we have a certain number of registered shares, and we've had to go through an exhaustive process through your agency to get those shares registered. We have to file proxy statements. We have to file annual reports.

But somebody, at a whim, can go out and issue 11 million of my shares in 45 days without any of those requirements. And so I just don't understand -- I understand all this discussion of locate and borrowed shares and all that. But I don't understand the underlying principle of why the long side of the market has such tremendous restrictions and barriers, but the short side of the market is the Wild, Wild West.

MR. MENDELSON: I guess my response would be that when there's naked short selling, which again is a practice I don't think any of us are proponents of, then that does have potentially the effect that you describe.

But covered short selling, where we borrow securities, does not have that effect. There's only one person who can vote a share, and that is the point, I think, of why we locate and borrow and deliver securities. And that's what's at issue here today.

But if that's done properly, I think the problem that Mr. Nixon is raising does not exist.
MR. NIXON: I disagree with that because we've seen a pattern of over-voting. But I still get down to the fact that if I have to issue -- if I want to issue 11 million more shares of my stock on the long side, I've got to go through a very diligent process, and a very exhaustive process, to do that.

And under the short side of the market, they simply have expanded my shares to another 11 million shares. And they've imposed them on a market situation on a short period of time where there's no effort being planned on the positive side of the market to acquire -- to ensure any kind of orthodox issuance.

Most people, when they go out and have a new stock issuance, have road shows, promote the value of the company, all of those positive aspects in issuing shares. And I have had a stock that's traded in the range of a couple of hundred thousand shares a day -- some people have joked that my shares trade by appointment -- and suddenly I'm trading at a million five and two million shares a day, and somebody in a short period of time dumps 11 million shares of stock on the market.

There is no way in the world that that stock can be defended against loss. I can't come out and make positive statements about my company because those would be forward-looking comments and I'd be slapped down for that.
But the short side can create all kinds of speculative comments and issue negative reports and draw questions against the company. And in the bear market which we've just recently experienced, there's almost no defensible position that a positive side of the market has. Nobody wants to listen to good news. They only want to listen to bad news.

So there's no defensible position on the long side. And so when the Commission is looking at this, I think it's important that we look at these technical and strategic issues, like we're dealing with today. But the big picture here is why should this go on?

Well, I can tell you why it goes on: because these guys make a lot of money out of lending stocks. I'm in the lending business. But I don't understand why we have an unequal playing field here. If you want me to compete, well, I'll compete. But I don't want to compete against a field that has a strategic advantage against me.

MR. DRISCOLL: As Mike --

MR. NIXON: And we've spent -- we've spent 30 years building value, which was destroyed in 45 days.

MR. DRISCOLL: As Mike said, legitimate short sellers go out and borrow the stock. And just to remind people that the beneficial owner of that stock can refuse to have it lent and restrict the short selling even more.
But legitimate short sellers are not creating phantom shares. They're actually going out and buying the stock -- or borrowing the stock.

MR. NIXON: And that's -- I would respond that that's also an interesting issue, too, because half of -- or two-thirds of the people who have their stock in margin accounts don't even know that the stock is being lent. You know, most people -- you ask the average guy on the street, is your stock being lent? They don't have an idea. They have no idea that that's going on.

Most of this is -- and I call this the Darth Vader side of the market, you know. And it's really not a very pleasant side of the market.

DR. HATHEWAY: We certainly have increased disclosure under the guidance of the Commission on short trading and now the aggregate short selling on a daily basis. And NASDAQ has long been in favor of the equivalent of a 13F disclosure for short positions as akin to what exists on the long side.

It's sort of an interesting concept on a disclosure document from a large short seller. I don't -- yeah. The long side doesn't have to reveal investment strategy. Should there be a different obligation on the short side to explain, you know, what they're doing and disclose? It would be a change for you all. But it's an interesting thought.
MR. LYNCH: And without getting into the kind of disclosure of what should happen in relation to long versus short, it's just important to have the underlying premise that legitimate short selling is very important in the marketplace. It creates a positive conflict as securities go up in value. It creates a positive conflict as securities go down in value. And it stops the ability of falling off the cliff with only sellers in the marketplace at a given time. So for an efficient marketplace, short selling is an extremely important part of it.

MR. BRIGAGLIANO: Well, that's a perfect place to end our first panel. I'd like to thank all the panelists for their thoughtful and candid insights. And we even got a good segue and preview of our next panel, which will be all about disclosure and transparency of short selling, and will promptly begin at 11:10. Thank you.

(A brief recess was taken.)

MR. BRIGAGLIANO: Today's second panel is entitled "Making Short Sale Disclosure More Meaningful: Public versus Non-Public Reporting; Consolidated Tape Disclosure; Timeliness of Information." I will be moderating this panel along with my colleagues John Polise, Assistant Director in the Division of Enforcement, and Brian Breheny, Deputy Director of the Division of Corporation Finance. Following introductions, the panelists will each make a brief opening
statement. Again, because we have a lot of information to
cover in a relatively short amount of time, we ask that
panelists limit their opening statements to no more than
three minutes.

As with our first panel, following opening
statements, the panel will receive questions from the
Chairman and Commissioners. Again, we encourage the
panelists to engage in dialogue with one another so that we
can have a lively and informative discussion.

Before we begin, let me welcome and introduce our
distinguished panel.

Dr. Jim Angel is an Associate Professor at the
McDonough School of Business of Georgetown University.
David Carruthers is the Head of Quantitative
Strategy at Data Explorers.

Richard Gates co-founded TFS Capital, and serves as
a Co-Portfolio Manager at the firm.

Michael Gitlin is a Vice President of T. Rowe Price
Group, Inc., and T. Rowe Price Associates, Inc.

Jesse Greene is Vice President of Financial
Management and Chief Financial Risk Officer of IBM.

Joseph Mecane is Executive Vice President and Chief
Administrative Officer for U.S. markets at NYSE Euronext.

And Michael Treip is Technical Specialist in the
Market Infrastructure and Policy Department of the U.K.
Dr. Angel, would you like to start us off with your opening statement, please?

DR. ANGEL: Thank you. Good morning. It's an honor to be here.

When we talk about transparency, there's one thing we must not forget. When we mandate transparency, we are imposing a compliance tax on the industry and an enforcement burden on the regulator.

Furthermore, we are confiscating intellectual property and breaching financial privacy. In order to do that, there had better be a compelling public purpose. And I believe, around short selling, there is a compelling public purpose that more than meets this very high burden.

For one thing, better transparency will promote market integrity. Whenever stocks go down, the short sellers get blamed. You know, there are allegations of unsavory activity, sometimes founded, often not. With better transparency, the markets can see for themselves whether indeed there is abusive short selling or not.

The second compelling reason is that of market efficiency, especially in the stock lending business. One of the problems with trading is what I call the prisoner's dilemma of trading. That is, you know, around trading, it's often said that I want to know what everybody else is doing,
but I don't want to give up any of my information.

And so we have a certain degree of mandated disclosure that makes everybody better off, and our exchanges and our regulations require in the equity business, in the fixed income business, in other areas, a certain amount of mandated disclosure. And it makes the market function much more efficiently, and we are all better off.

You know, and so for these reasons, I support better transparency, both with respect to short selling, with respect to short interest, and with respect to stock lending.

Thanks.

MR. BRIGAGLIANO: Thank you, Dr. Angel.

David.

MR. CARRUTHERS: Thank you. Good morning. My name is David Carruthers. I'm actually the head of quantitative services rather than strategy at Data Explorers. So my position in the company is one where we're looking at data in a fairly neutral way. So I hope that my comments can primarily focus on what our data can tell you, and provide a bit of a backdrop to some of the discussion in this session.

Any discussion of short selling disclosure does have to clarify the reason why the disclosure is deemed to be useful. For long positions, disclosure is primarily avoiding a stealthy buildup of a control stake, so it's primarily to
protect the interests of minority shareholders.

When we look at short positions, we have to think equivalently of who is the disclosure aimed at protecting. In general, I think we would all agree that the objective is to prevent market abuse and prevent the development of a false market, or to prevent situations where market participants take advantage of a vulnerable company or simply a thinly traded market for stock shares.

In addition to my written comments, I'd like to add here a comment about the situation last year in Volkswagen shares, where despite the disclosure rules that are generally in force in Europe, although perhaps not so strongly in Germany, there was in fact a stealthy position, an enormous stealthy long position, built up in cash-settled options in Volkswagen shares by Porsche or their representatives. The sudden disclosure of that had an enormously destabilizing effect on the marketplace, and I'll talk about the short side of that later on.

In the experience of Data Explorers, data of short selling has a number of facets. It's primarily used for hedging by market makers, option dealers, arbitrageurs, and so on. That short selling is, as has been discussed in the previous panel, covered by a stock loan, especially since the 2008 crackdown on naked shorting.

However, we should remember that there are OTC
derivatives such as total return swaps which may not actually involve any kind of underlying dealing in the stock or short sale.

Much of the concern, as has already been voiced, around short selling is centered on the illegal and well-documented and policed activity of naked shorting. However, directional shorting is clearly also controversial. Anecdotal or, rather, informal research on our part suggests that the directional shorting is around 20 percent of the total. The rest is for the hedging purposes.

A key question is: Does short selling create false markets, and does it or indeed can it drive down stock prices? There are various academic papers which suggest that covered short selling is generally beneficial to markets, gives greater liquidity in bid/offer spreads.

However, since auctioneers need a buyer, the impact of covered shorting should in general be neutral, only market-negative if there is an imbalance of buyers and sellers. However, naked shorting does allow, as we've heard, the unlimited creation of synthetic shares.

In our experience at Data Explorers, most short positions actually build up very slowly, not in such a way that would normally move the market. On the other hand, a very important phenomenon is where the accumulated short position may have to be unwound very quickly and we move the
price sharply upwards. Again, the Volkswagen case of 2008 was an extreme example.

We were inundated at that time with requests for data about the size of the short position, and most of those requests were coming from short sellers concerned that their position was so big that the pain could go on for quite some considerable time.

So the irony is that if you disclose short positions in the same way as you disclose long positions, the people you may be protecting are the short sellers or long fund managers who are underweight of stock compared with a reference index.

A further point from our data is in general, with short selling, what we see in our data is the anticipation of news and events rather than, in general, the driving down of share prices; whereas what we do see is the technical driving up of share prices through short squeezes.

We've also seen a fair amount of evidence that the institutional ownership changes are as good at predicting share price movements. In other words, there is that same symmetry between the long and the short sides of the market when we look at what we might call informed traders.

The final two comments about transparency: Anonymous disclosure of short positions in itself is unlikely to harm the market. The issue comes when you set up some
kind of feedback loop, and the disclosure of the data then creates another round of activity. The Volkswagen situation is a case in point.

Finally, a question about public reporting versus private reporting. Our view is that there's room here for a strong public/private partnership, with public collection and private distribution that will almost immediately show which data items and metrics are the most valuable because those will be the ones that will be picked up by the private sector.

Those are my comments. Thank you.

MR. BRIGAGLIANO: Thank you, David.

Richard Gates.

MR. GATES: On behalf of TFS Capital, I would like to thank Chairman Schapiro and the Commission for inviting me to participate in this roundtable discussion. As the founder and portfolio manager of a 12-year-old asset management firm, I am eager to share in an open dialogue on ways to enhance regulations to better our industry.

I enter this discussion knowing that academic literature suggests that short sale transactions add liquidity to the marketplace, reduce bid/ask spreads, and aid in price discovery.

And outside of the two recent enforcement actions for Reg SHO violations, I have not seen evidence that
suggests that short sellers are responsible for pricing a
security at a level that is inconsistent with its fair value.
Restated, for the most part I don't think that short sellers
manipulated prices or engaged in abusive trading during the
financial crisis.

For these and other reasons, I believe that short
sellers have an unfair reputation in the court of public
opinion. However, I come to the Commission happy to know
that it is carefully and cautiously evaluating any potential
regulation changes related to short sale transactions.

Now on to the topic of the panel, disclosure.

To me, good disclosure should meet two basic criteria. The
first is that each disclosure requirement should stand on its
own feet. In other words, it should provide real value to
individual investors and the market as a whole, even when
required costs are considered. And when considering costs,
it is of course important to consider both the direct and the
very real indirect costs that exist.

The second principle with respect to short sale
disclosure is that short sale sellers should not be subject
to more onerous requirements than long-only managers. The
reason for this is that it creates an unlevel playing field
in the market that favors one participant over another. It
also furthers the misconception that we are irresponsible
investors that need to be scrutinized closer than our long-
only counterparts.

With these principles in mind, I will make a couple quick comments on three specific disclosures.

The first is that in general, I think that a short sale disclosure should match disclosures that are required for long positions. More specifically, I think short positions should be reported alongside long positions in forms such as the 13F and the 13D.

In addition to serving a similar purpose to the current long reporting requirements, such short sale disclosures could also provide other value as well. For instance, by capturing positions on both sides of a trade, it could be determined that a manager has a large boxed position. Such information could provide insight into issues like empty voting.

Next up are failures to deliver. I don't think anybody, any of the panelists that I've seen in the last couple of days, want fails to exist in the marketplace. While I think it's still -- it's much less of an issue now than it was pre-Reg 204T, I'm a fan of having as much disclosure that the Commission thinks it needs to help it eliminate future fails and tighten up Reg 204T as necessary. Of course, the market's integrity is impacted by fails, and fails can occur on all different types of transactions.

The last specific disclosure requirement I hope our
panel discusses, with David's assistance, is the aggregated short sale data that is now reported twice per month by the exchanges. This is a widely used metric, and is one that I believe is very important.

Unfortunately, I also believe that is underestimate the actual number of shares sold short. Its major flaw is that it lacks positions held at non-U.S. firms. In addition, it's my understanding that it may also exclude positions held in arranged financing platforms, swaps, and enhanced leveraged relationships that are set up through the United States.

Unfortunately, I believe this data is the cornerstone needed to fully understand short sales, their corresponding purchases, and the stock loan industry overall. In other words, if we want to have a thorough understanding of what is happening in the financial markets, I suggest a careful analysis of what can be done to get this figure described more fully and completely.

Before I wrap up, I would also like to share one parting thought. That is, when putting all of this together, I encourage the SEC to consider the pending regulation to make hedge fund managers become registered.

If or when this gets enacted, these managers will be required to maintain hoards of transactional-level data that presumably will include a high percentage of the short
sale transactions that exist. With just this one change, the
SEC will then have access to far more information on short
sale transactions than ever before.

Thank you again for including me. I look forward
to the dialogue.

MR. BRIGAGLIANO: Thank you, Richard.
Michael Gitlin.

MR. GITLIN: Thank you, Chairman Schapiro and
members of the Commission, for the invitation to appear here
today. I'm pleased to participate in this roundtable on
behalf of T. Rowe Price to examine short sales, and in
particular, to discuss additional transparency measures for
short sale-related information. T. Rowe Price is an
independent global investment management company, and we
welcome the opportunity to be a part of the industry dialogue
on important market practices.

As a starting point, we urge the Commission to
continue to work closely with foreign regulators to encourage
symmetry in the regulatory schemes across borders as more and
more firms such as our operate and trade in a global
environment. We are also supportive of the Commission's
commitment to work with SROs to discuss additional public
disclosure.

We firmly believe the benefits of public disclosure
of short sale positions outweigh the potential drawbacks.
Added transparency in the form of regular public short sale disclosure reporting will help remove the mystique around short selling, will put all market participants on the same level playing field, and will provide regulators with an efficient tool to monitor short selling.

In formulating specific frequency reporting requirements and threshold triggers, we are in favor of a commonsense and fair approach whereby short selling would generally be no more or less onerous than current long position reporting requirements.

There will likely be many views on the specific details for both reporting frequency and threshold trigger questions. But we think the primary question of whether to report -- to require public disclosure for short sales is straightforward and indisputable.

Industry participants are currently required to publicly file long positions, and we see no reason why short sellers would not have to meet similar standards. We believe the market would benefit from such enhanced disclosure.

We think the time frame for short position disclosures can generally mirror the reporting timelines that exist for long positions. Similar to Section 13, we imagine two levels of reporting detail.

Firstly, largely symmetrical to 13F, there could be a standard quarterly reporting requirement for all short
positions that are above a de minimis threshold. Secondly, there could be another reporting requirement triggered when a short position reaches a significant threshold, due within ten days of execution, much like the 13D requirements. This approach is straightforward and consistent with long reporting requirements.

We think it's important to have threshold triggers in place that provide the market with a proper amount of transparency. Determining the proper thresholds for reporting should elicit varied opinions and commentary. Therefore, we think the Commission should examine relevant empirical data and ask for input from investors before determining these thresholds.

The real time tagging and display of short sale executions on the consolidated Tape would provide market participants with a more in-depth understanding of trading activities in any given security on any given day. By marking short sale executions as short on the consolidated Tape, we are creating an equal and fair marketplace whereby long sales would necessarily be recognized as having been sold long.

Another benefit of real time tagging and display of short sale executions is the demystification of short selling. The ongoing debate of what caused an individual security to decline would largely disappear with this added
level of transparency. We believe the benefits of the consolidated Tape reporting for short sales outweigh any additional costs.

In conclusion, while there are different empirical arguments for and against the uptick rule and other regulatory measures, we feel strongly the issue for short sale disclosure is just that, an issue of disclosure. We are in favor of short sale reporting requirements that largely mirror existing long position reporting requirements, and we're in favor of short sales being denoted as such on the consolidated Tape.

Market participants will know what is being sold long and short in any given security, and added transparency in this regard on a real time basis can only help to inform market participants and calm investors' concern about short selling.

Rumors, misinformation, finger-pointing, and the emotion around short selling can be addressed by both regular short position disclosure and consolidated Tape reporting requirements. Such information should be useful for regulators as they attempt to instill market confidence and monitor market manipulation.

I thank the Commission, and look forward to the discussion.

MR. BRIGAGLIANO: Thank you, Michael.
Jesse Greene.

MR. GREENE: I would like to thank Chairman Schapiro and the Commission for inviting IBM to participate in the Securities Lending and Short Sale Roundtable discussion. We applaud the SEC for hosting an in-depth review of short sale pre-borrowing requirements and additional short sale disclosures.

As we have indicated in our comment letter about the SEC proposed rules on short selling, capital markets are important drivers of our economy. Their purpose is to provide capital to business in order to advance our economy. And there are other consequences.

How a stock trades is often viewed as an early indicator of the health of a company, which impacts shareholders, customers, and employees. Corporations work hard to make sure the information in the marketplace about their firm is accurate and complete.

Corporations measure success of their effort via feedback from and dialogue with those who own and transact in their stock. We know the identity of the most influential long holders due to the stock ownership, as disclosed in Form 13F filings. We know little to nothing about large short positions and short selling activity due to the lack of disclosures by short sellers of their positions.

Investors' ability to access full and complete
information about the company in the marketplace is impacted by what the SEC does after today's meeting. It is imperative that the SEC work to restore confidence by putting in place regulations that prohibit manipulative trading tactics and foster a fair and balanced information flow to enable a stable marketplace trading on fundamentals.

We commend the Commission's recent efforts to address abusive short selling tactics. The SEC rules issued in October of 2008 and the adoption of interim final temporary Rule 204T tightened the controls around short selling, and are a step in the right direction to reduce fails to deliver and address potentially abusive naked short selling.

However, there are also opportunities for the SEC to improve transparency with regard to short sale disclosure standards. As detailed in our comment letter, we have suggested that the Commission consider a comprehensive regulatory framework for short sales that would improve market stability and restore investor confidence, including public disclosure of short positions held by institutional managers with equal rigor to Form 13F requirements for long positions.

A simple example demonstrates the point we are making. Under the federal securities laws and the SEC regulations implementing those laws, they apply different
disclosure standards for short positions in securities than are applied to long holdings.

For example, an institutional investment manager may have a long position in ABC Company, implying a bullish view of the ABC Company. What the ABC Company and the investor community do not know is that the same institutional investment manager may have a substantially larger short position in the ABC Company, which implies a very different view of the company's prospects.

As illustrated, it's not clear that the distinction for short and long disclosure standards has a rational basis, and it may result in misleading and incomplete information in the marketplace that diminishes the effectiveness of the required disclosures.

Transparency in our financial markets is critical, and institutional investment managers should not be allowed to conceal certain positions while being required to disclose others of similar magnitude.

It is vitally important that the securities laws provide for complete and balanced disclosure, and that these laws are applied in a fair and equitable way. We believe that parity in disclosure standards for short and long positions in securities is a significant step in restoring fairness to the capital markets.

Without it, issuers are unable to address the
concerns of those betting that their business will fail, as they would their significant shareholders betting on the company's success, and investors do not have the information to gauge the true value of equities.

Thank you, and I look forward to the questions.

MR. BRIGAGLIANO: Thank you, Jesse.

Joe Mecane.

MR. MECANE: Thank you, Chairman Schapiro and Commissioners. I appreciate the opportunity to offer our views today on the reporting and disclosure aspects of short sale regulation.

The NYSE believes that short sales are an important tool in the maintenance of an orderly market. We also believe that some information about short sales can be a useful tool for market participants.

For example, the NYSE, NYSE Amex, and NYSE Arca, offer daily and monthly short sale transaction summaries. In addition, NYSE and NYSE Amex offer customers a semi-monthly file that contains the reported uncovered short positions on securities listed on NYSE, NYSE Amex, and NYSE Arca. The data for this is obtained from the reports provided by member firms under FINRA Rule 4560.

Separate from these publicly available reports are regulations requiring audit trails and the marking of orders to identify whether a sale of an equity security is long or
short. These requirements assist the Commission and self-
regulatory organizations in determining whether market
participants are complying with regulations such as Reg SHO.

These two types of short sale reporting illustrate
different policy objectives. The short interest report and
the Exchange's proprietary short sale transaction reports
respond to investor and company interests. The audit trail
information, on the other hand, is needed to prevent and
detect fraud and manipulation in the market. We believe it's
essential to keep these different policy objectives in mind
as we consider enhanced disclosure.

We believe the Commission should also bear in mind
that there is a conflict between the potential benefit to
investors and companies from disclosure of trading
information and the proprietary interests of investors
seeking to execute a particular trading strategy in the
market.

The questions thus are, one, will any change in
disclosure mandated by the Commission serve to materially
enhance the market by providing investors and companies
information that they need without encroaching on investors'
legitimate need for confidentiality? And two, will the
disclosure enhance a regulatory oversight objective?

Other factors to be considered include whether the
costs of providing the information outweigh the benefits, and
whether the information may have unintended consequences.

We can apply this analysis to the questions that you've asked us to address. With respect to whether a short sale indicator should be added to the consolidated Tape, our view is, first, there appears to be little regulatory benefit from this disclosure because the information is already captured by market centers and is available to the Commission.

However, for a relatively low cost, additional disclosure of real time activity could be beneficial to the markets, although we should continue to evaluate whether that disclosure could have unintended consequences.

Increased short reporting may be of some benefit to investors and companies. The increased cost of collecting and providing this information should be incorporated in the cost/benefit analysis. But it's our view that the public disclosure of an investor's short position should be based on a policy determination that the benefits of public disclosure outweigh the principle of protection of otherwise confidential information.

A reasonable place to start could be disclosures similar to those under 13F or 13D, with additional public debate around the cost of more frequent or detailed level disclosures.

The NYSE's primary interest in increased short sale
Disclosure is whether it will enhance the ability of regulators to detect and prevent fraud and the manipulation of stocks traded in our market. On that basis, there are compelling reasons for increasing the confidential disclosure of concentrated proprietary short positions on a more frequent basis for regulatory purposes as we continue to debate the cost and benefit of public disclosure.

Detection of manipulation is made more difficult today not only because the market for trading stocks is fragmented, but also because of the increase in derivative products and transactions. It's beyond the capability of any one market center to effectively police trading across one venue -- I'm sorry, across all venues.

We think the solution is to consolidate responsibility for market surveillance and to be sure that the designated regulatory body is equipped with the tools needed to perform that surveillance.

I look forward to your questions.

MR. BRIGAGLIANO: Thank you, Joe.

Michael Treip.

MR. TREIP: I'd like to thank Chairman Schapiro, the Commissioners, and the SEC staff for inviting the FSA to participate in this roundtable.

The FSA regards international dialogue and, where appropriate, convergence on short-selling regulation to be
critical. I personally wear two hats in this context. I
have led much of the work developing the policy in the U.K.,
but I also sit as the chair of the CESR -- that's the
Committee of European Securities Regulators -- the CESR Task
Force on Short Selling. So I have a twofold role.

It's worth mentioning a couple of points by way of
background before I go on to a few key issues.

Since the 18th of September, 2008, the FSA has
operated an individual position public disclosure regime with
respect to U.K. financial sector stocks. In the first
quarter of this year, we published a discussion paper where
we indicated that we didn't favor any form of ban or direct
restraint, but we did propose that we felt the most
appropriate form of regulation was that holders of net short
positions of 0.5 percent and above in all U.K. stocks should
have to disclose those identifiable individual positions to
the market as a whole.

We also thought that these obligations should kick
in at a lower level, not 0.25 percent, where the company in
question was engaged in a rights issue. These disclosures
would be made by the end of the trading day after the day on
which the position was reached. Those engaged in genuine
market making activities would be exempt from the obligation.

We will, in fact, publish our feedback statement to
these proposals tomorrow.
Proposals in a CESR consultation paper on disclosure that was published in July of this year are very similar to the FSA's, apart from the fact that CESR proposes that there should be one additional lower threshold for so-called private disclosure to the regulator, and that should be at 0.1 percent. That consultation, in fact, closes today.

So what is our thinking on what I see to be some of the key issues of interest today? We note, of course, the beneficial impact that enhanced transparency has on market efficiency. But I have to say our principal objectives in the short selling space are to mitigate the risks of market abuse and disorderly markets that we consider it to pose.

We believe this is best achieved by enhancing transparency of investors' short interest, howsoever the short position is reached. That is the reason for our interest in position reporting.

In addition, with one exception, the infrastructure for sales reporting simply does not exist in Europe, so the implementation costs of sales or transaction reporting would be very great indeed.

The second issue, as I see it: Why public disclosure? We do want the market as a whole to receive better quality information around short selling. But we also want to have some impact on investor behavior through a disclosure regime. And we feel it is very important to be
open and up-front about that motivation.

Let me come to that point now. Why identify the position holder to the market, as we propose? I can say unequivocally that we do not want to halt short selling in non-crisis market conditions. We recognize the beneficial role it plays in markets.

What we do want to do, however, is create a degree of deterrence against the most aggressive short selling by requiring short sellers to consider their trading strategies as they approach the public disclosure threshold.

We recognize that there are concerns in some quarters about phenomena such as herding; enforced disclosure of intellectual property, that's been mentioned already; short squeezes; and ultimately, it's argued, reduced levels of short selling; and lower market quality. But from our analysis of the impact of a disclosure regime in the U.K., we have not seen these concerns crystallize to date, so we think our proposed model strikes the right balance between competing interests.

Two further issues to mention briefly. Why no aggregation by the regulator, as is on the table from some respondents? Clearly, this can facilitate some of the informational benefits that we're looking to gain. But we think, because of the inherent anonymization that's involved, it will not result in any significant changes of behavior.
It also, I have to say, carries with it resource implications for the regulator.

And finally, why, as we proposed, disclosure at T + 1? We're not seeking to achieve genuine real time disclosure. With the current market infrastructure in Europe, this would be disproportionately burdensome on the market and unmanageable for the regulator.

However, if the market is to benefit from current and meaningful information and we are to have an impact on the most aggressive trading strategies, we do believe that disclosure should be timely. And our current measure of timeliness is one day.

Naturally, I know that there are many other issues, and I'm sure these will come out in the ensuing discussion.

Thank you.

MR. BRIGAGLIANO: Thank you very much, Michael.

Thank you, all the panelists, for your thoughtful statements.

We're now open for questions from the Chairman and Commissioners.

CHAIRMAN SCHAPIRO: Thanks, Jamie. I'd like to follow up with Michael. And I should start by thanking you for coming from such a long distance to help us today. We're very grateful for that.

You've had the benefit now of about a year's experience with your disclosure regime in the U.K., and you
highlighted some of the things people worried about that would result from the revelation about trading strategies or herding or other potential consequences of having a disclosure regime.

Were there any negative impacts, as you look back over the past year, from requiring the disclosure that you do require? And from your perspective, and I guess I'd like to know what industry would say was negative impact from the disclosure regime, or positive?

MR. TREIP: Thank you. I'm loath to start off with some caveats, but I feel I should. Firstly, we have to be cautious trying to extrapolate how -- a very broad scope regime is the one we're proposing -- may pan out on the basis of a really very narrow scope regime, which is what we've had to date. But that is the data we have.

Secondly, of course, that regime has operated in a number of contexts, which have almost certainly distorted any measurements that we can make. Firstly, for the first three or four months of the operation of our disclosure regime, we also had a ban in relation to the active creation or increase of short positions in U.K. financial sector stocks. So in a sense, we have to disregard that data because it's in that context.

We have actually worked a little bit with David's organization and looked at stock lending data. And although
our analysis to date has not been hugely sophisticated and we are working further, we really have seen relatively little impact, as far as we can see, from a stand-alone disclosure regime on levels of short selling.

We have seen changes, but those have really been in line with what we would expect from the underlying trends in the market. Levels of short selling seem to have gone down over the last few months, but pretty much at exactly the same level as the markets have broadly gone up, which is what we would expect.

So on limited data to date, we haven't seen an enormous negative impact. We did see some impacts from the period we had a ban in place, which we would not necessarily want to have on a long-term basis, such as a widening of bid/offer spreads. But disclosure alone, not a huge impact.

COMMISSIONER PAREDES: To pick up on an aspect of what you had just mentioned in terms of the studies, and you're still pushing further to kind of make them more robust, if you could maybe just say a little bit more about what the limitations are on the studies so far, and what the plan is on a going-forward basis, and why you think that will yield more robust results, whatever they happen to be in substance.

MR. TREIP: Well, one of the limitations -- and again, I'd really like to pick this up with David, perhaps in
the margins -- is that we've struggled a little bit to actually come upon what would be meaningful data to reflect herding behavior or squeezes. And clearly, those are two concerns which have been expressed very loudly. So David, if you have thoughts on what Data Explorers has seen in that, I'd be very interested.

The other limitation, of course, is that as we all know, stock lending data, which is really the main source of information we have, is a proxy, and it's not a perfect proxy, for levels of short selling.

And also, a third limitation is the point that's been made a number of times this morning, is that of course short selling is conducted for a number of reasons, some of which are relevant to our objectives and some of which are not. And some data would suggest that the majority of short selling is done for purposes which really have no link to our regulatory objectives.

So going forward -- I apologize, David; there was an element, a further element to the question -- we really are at a very early stage as to how we can make our analysis more sophisticated.

MR. CARRUTHERS: I can perhaps add to some of Michael's comments by telling about some of the research that we've done at Data Explorers. If I could also say thank you very much for the opportunity to present to you; I think I
may have omitted to do so in my opening comment. Apologies.

I blame jet lag.

The work that Michael has mentioned was very interesting because we worked with the FSA, including a number of members of the market abuse committee there, some of whom had fairly extensive industry experience, having worked in investment banks themselves.

So there's really two things. One is a roundabout short selling in the form of covered shorting that you collect data on and you can identify and it's transparent. And here in the U.S., you do calculate short selling data and publish it every two weeks with a delay.

We've compared the stock lending that we collect with the public data. There's certainly a very considerable overlap. But if you think of it in terms of two sets overlapping, there's definitely situations where people borrow stocks, such as pre-borrows, which are not reflected in short selling; and situations where people short sell without it being reflected in a stock borrow, hedging being one of them.

So when it comes to the herding that you talked about, I think we can identify fairly closely, but not exactly, through stock lending data what the short side of the market is up to, at least where its legitimate activities are concerned.
The points I made about Volkswagen apply here, that some of the largest positions that we see -- and I'm talking about where the percentage of a company's shares that are actually on loan and hence broadly shorted are perhaps over 5 percent, which would be a typical disclosure for a long position.

Once you get to that stage and beyond, there is actually a very significant danger that there will be a short squeeze. There will be short covering. And anyone who is short is extremely vulnerable to that because if you think it's unpleasant to be on the receiving end of a falling share price, it's even worse to be on the receiving end of being short when share prices are rising. The panic levels around about the Volkswagen situation and the Citigroup short squeeze earlier this year were evidence of that.

Where I think the conversations with the FSA revealed some very interesting points was around about the definition of naked shorting. We discussed this for about two hours, and it became obvious that there are a number of ways in which naked shorting can actually manifest itself, which are very difficult to track down.

The previous panel talked about the level of fails, which is certainly one of the ways you can track it, but not the only. There's also the possibility of putting a trade on and then disappearing off to get a coffee, coming back and
closing it out again, all within the space of half an hour.

That in itself is a form of short selling.

And there's the derivatives that I mentioned, where you can create a contract which replicates the behavior of shorting without there being an underlying trade, and the risk is on the side of the person who decides to write that contract and not hedge it.

So in reality, the naked shorting is a little bit like water. It flows through all sorts of cracks everywhere.

It can be very, very difficult to make that completely watertight.

COMMISSIONER PAREDES: On the disclosure point, I'm curious, going to the professor, whether or not there's any relevant academic literature that gets at -- whether from an empirical perspective or perhaps a theoretical perspective, given the limits of the data, that would offer some insights in terms of what the expected results are from different types of disclosure.

You had mentioned, I think, in your remarks that there's a whole lot of benefit to having more transparency in these respects. But a couple of you recognized that at some point there of course are costs that need to be factored in.

And I'm curious, in terms of the academic take on it, what is out there again, either empirically or theoretically.
DR. ANGEL: I'm not aware of any academic studies that look at any transparency regimes that are of interest here. We have seen in areas like with bonds, for example, that when we got better price data, the bond market functioned better.

One thing I would suggest, since short selling represents 25 percent of our equity trading volume, that we carefully design any changes in a way that we can investigate the results. For example, phasing in new disclosure regimes or, better yet, having carefully controlled pilot experiments, as was done with Regulation SHO. In that way we can intelligently gather the data we need to find out, you know, the impact of any new disclosure regime.

CHAIRMAN SCHAPIRO: Could I -- I want to make sure I understand. In the U.K. regime, and I guess what's contemplated with CESR, is non-anonymous disclosure, disclosure by entities of short positions. Is that correct?

MR. TREIP: That is correct. The CESR proposal would have a private disclosure to the regulator at a low level, and then at the more significant level, a public identifiable disclosure.

CHAIRMAN SCHAPIRO: Okay. So David Carruthers, I don't want to put you on the spot. But your submission talks about "Anonymous disclosure of short positions is unlikely to directly harm the market."
Do you have a view about identified disclosure?

MR. CARRUTHERS: I think the critical issue is the timelag. I think that if you have disclosure a few weeks later or a few months -- it depends on someone's trading strategy -- but in general, if some time after the fact it's named, then in general, that shouldn't be an impact.

I think it was mentioned earlier about the prisoner's dilemma, the problem that you have with markets, that if we have full transparency, you may reach a situation where no one would trade because everybody knows everybody's positions.

So the FSA's definition of timeliness is one day. I would imagine that if you were to name the -- if you were to make it non-anonymous, it would certainly have to be significantly more than one day for the market participants to feel comfortable. It really depends on their turnover level, how fresh that data is and whether it would place them in a disadvantageous position.

CHAIRMAN SCHAPIRO: Do others of you have views on that, on anonymity?

MR. GITLIN: One thing I'd say is when we're contemplating looking at herding and short squeezes, if we look at a level playing field -- and that's one of our missions, is try to get a level playing field -- on the long requirement right now, when someone like T. Rowe Price
reports its positions in 13F filings, we have the same risk
of effectively long squeezes.

When we own up to 15 percent of companies and when
we report in our 13F filings, we have the same risk of people
seeing that filing, noting T. Rowe Price may own a 5 percent
position and may be on its way to a higher position and then
could buy ahead of us as well.

So I would just think of that in the context of a
level playing field and timelines.

COMMISSIONER WALTER: Can we talk for a few moments
about the exceptions that are in the U.K. and proposed CESR
regime? As I understand it, there is one for market maker
transactions that are bona fide, genuine market maker
transactions.

And I wondered if, Michael, you could comment on
why it's there, how you define it, and what other types of
exceptions you think might be appropriate.

MR. TREIP: Certainly. Commissioner Walter, you
rightly identify that the market maker exemption -- really in
carving out that role from obligations.

But we are recognizing the role that short selling
generally, and particularly market makers, plays in relation
to liquidity. And we do feel that it's very important not to
over-egg the pudding, if I can put that way; and to impose a
disclosure obligation without any exemptions whatsoever could
actually take the impact on liquidity too far.

We are -- that's our core principle at stake.

There have been arguments from some quarters within Europe that we should actually have a very broad definition, that we should actually talk about liquidity providers rather than market makers.

We in the U.K. feel that that would be taking it too far. That's creating a charter for an awful lot of people who will put their hands up saying, yes, we provide liquidity, too, so we don't have to make any disclosures.

So we are holding the line. And there is a consensus in Europe that that line should be held on this concept of market making. That then begs the next question as to how precisely we should define that.

The FSA has put forward a definition -- I won't go into the precise details of it -- in our frequently asked questions, which does slightly diverge from our technical definition in our rule book.

But one thing we are conscious of within the European context, again, is to avoid a proliferation of definitions. Market makers are defined, I believe, already in three different ways in three contexts within European legislation. So we have to be careful. We have to be cautious about creating a fourth definition.

COMMISSIONER WALTER: So is it principally -- are
there any other significant exceptions, and the rationale for
this one that makes sense is the liquidity provision function
that's being served on a pretty constant basis. Are there
other rationales that would justify exemptions as you
consider those?

Mr. Treip: Well, we've had various representations
made to us. One that was mentioned relatively recently when
I attended a CESR open hearing was that positions as a result
of ETF trading or indices trading or basket trading should be
exempt.

Our feeling quite strongly, and I know that there
is a CESR consensus on that, is that that should not be
exempt. We recognize that it may create logistical
difficulties in actually determining your precise position in
relation to the components of an index, for example.

But let's say if you look at what -- the regulatory
objective we're seeking to achieve, we feel that the same
risks apply, and therefore the same solutions should be
applied to them.

Commissioner Walter: Thank you.

Do others of you have any things about any other
aspects that you think deserve exemption from a disclosure
regime?

Mr. Mecane: I would just add that I think it's
important to look at that question and a number of the other
issues in the context of activity versus positions because there tends to be, I think, a lot of confusion in general with regards to those two types of disclosures.

I think with respect to positions, you probably don't need exemptions because, by definition, market making tends to be flat and not carrying a lot of inventory, so positions wouldn't necessarily need an exemption.

But I think with respect to activity, and when I mentioned unintended consequences with respect to putting short sale locator on the Tape, I think that's where you have the potential for a lot of confusion.

Because you could end up seeing a very large amount of short selling activity happening throughout the day, especially in the way that, you know, the high-frequency type activity has evolved, that doesn't actually result in short selling activity -- I'm sorry, in a net short position at the end of it.

And there's nothing -- there's no issue with that other than it makes it very difficult to interpret what value you get out of the disclosed activity because you can't necessarily dissect all the short selling activity that happened and what's behind it, meaning there could be a very large amount of activity that happens that does not end up any net short position. But someone just looking at the Tape or looking at that data has no way to see that.
So I think that there's a valid case to be made around whether, you know, exempting market making activity from a more real time disclosure might help improve the quality of the activity disclosure. I think then, you know, where that evolves into and where it gets very, very complicated is that, you know, how do you define that activity that should be subject to the exemption?

And obviously, we're dealing with that in a number of different contexts in terms of how to define a market maker because you could exempt a certain type of activity, and then a lot of activity that doesn't necessarily qualify for it ends up, you know, behaving similarly.

So it's a difficult question, obviously, to resolve. But it's something that I think should be part of the debate.

MR. POLISE: Joe, can I follow up on something quickly on that? I'd like to talk about it not from the public disclosure aspect, but from the regulatory disclosure side.

MR. MECANE: Yes.

MR. POLISE: And when we make the distinction between activity and positions, the relative merits of the pre-marking requirement -- for example, pre-trade, when somebody's doing a high frequency trade, which may end up in a net flat position, versus the post-execution disclosure.
From a regulatory purpose, I think I would take a
different tack, which is you need to know what the intent is
at the time the trade is executed -- I'm sorry, at the time
the trade is put in.

MR. MECANE: Right.

MR. POLISE: And I was wondering if Michael had any
thoughts on that from the United Kingdom as well.

MR. TREIP: I do apologize, Brian. I was just
making a note of something else. I didn't quite catch the
second half of your question.

MR. POLISE: The relative merits of a pre --
sorry -- order entry marking regime versus a post-execution
net position. That is, it comes up more frequently with high
frequency traders who may not know or claim not to know
whether they're actually going to be short or not at the end
of the trade.

MR. TREIP: It's a fair question. I mean, we
recognize that with high frequency trading, and indeed with
intra-day short selling, which in the U.K. we believe makes
up much of the naked short selling activity, it's not going
to be captured by the sort of position regime we have. The
problem -- and, you know, an obvious solution for means of
creating transparency in that space would be through having
flagging or marking of transaction reporting.

The stumbling block, as I've mentioned already, in
Europe is that that infrastructure simply doesn't exist. And we do feel that the very great costs of putting some kind of marking regime in would then really strain the cost/benefit analysis.

MR. POLISE: But Joe, you think that's probably possible here in the United States? We have a fragmented but still somewhat centralized market, maybe not for public disclosure but for audit trail purposes.

MR. MECANE: Right. I mean, I think the issue that you're raising is more around how a lot of the high frequency business models have evolved over a number of years. And I think there's consensus. You know, there's been a lot of, I think, debate on both sides of that issue in terms of how orders should be marked.

And I think it's largely an outcome of the fact that, you know, a lot of strategies are executing or at least posting orders in multiple markets simultaneously. And so, you know, the intent is really for only one of those orders to get executed. But obviously, you know, they're spreading their interest around in the hopes that, you know, of those will get executed and they could cancel the balance.

So I think, to your point, to the extent that the reporting requirements in those situations get harmonized and become more of a pre-trade definition of what your intended activity is, it certainly helps clean up the audit trail. My
point was more even if we go in that direction and all the trades that we consider to be short are marked as such before the fact, those trades could subsequently be covered, shorted, covered, you know, very frequently throughout the day.

And from a public disclosure standpoint, seeing all that activity and just looking at, let's say, what the net effect of all the shorting is is difficult to know because, you know, positions are established and covered continuously. So I think the clarification that's out there simplifies the definition of what short sale activity is.

But I think you still end up with a feedback mechanism.

CHAIRMAN SCHAPIRO: That's a really interesting discussion, I think, about the potential for putting an indicator, a short sale indicator, on the Tape.

I wonder if any of the others of you have any view about that, and whether there would be any advantages to having that kind of information available, perhaps in some way to provide the context so that it's not misleading to investors.

MR. GITLIN: I think one of the interesting things about having it denoted as such on the consolidated Tape, in what Joe describes, what you'd end up with is information in itself. So if what Joe describes would occur, where there'd be lots of trades that ended up net but looked like shorts on
the Tape, that ended up flat at the end but were actually
shorts, that's good information for market participants to
know that a lot of the activity in that name was actually
just electronic market making activity and not fundamental
activity.

And that's an important piece of information for
the marketplace. So I would use that as a reason why marking
on the consolidated Tape -- and from what I understand from
both NASDAQ and NYSE is that that can be done tomorrow -- why
that would be a benefit for participants as a whole.

I don't know if the professor has any thoughts on
that, but I think I've read in one of your comments that you
thought that might be positive.

DR. ANGEL: Yes. I concur. I believe that the
instantaneous real time marking would help to assure
investors that there is a lot of legitimate short selling
that you see under normal circumstances, that not every short
seller is a predator, and that if there is an abundance of
short selling, people can see it, you know.

So in this way we won't have people wondering about
what kind of mysterious conspiracies are taking place in the
dark. So I think transparency on a trade-by-trade basis is
something that we can achieve easily, at low cost, and with
very little harm to the rest of the market. So I think we
should do it.
MR. MECANE: If I could just add, very quickly, just to clarify one thing. So it's definitely something that could be easily done. And just to be clear, we are in favor of that level of disclosure.

I think, though, to the point that Michael just made, if you have the activity but not the position, it then becomes difficult to back into how much is transactional versus establishing a position. So I think the two are somewhat related, meaning they go hand in hand.

The issue that comes up is just the time lag between those two because, you know, assuming we had a 13F or 13D type regime, we just need to recognize that there's a time lag involved if we're doing real time activity reporting, but then delayed position reporting for valid reasons. There's just a time lag between people -- you know, for people to be able to do that analysis to separate the two pieces out.

MR. CARRUTHERS: If I could add one comment from our experience. We collect quite a lot of regulatory data already, and we do collect around about 3 million transactions every day. And what I can tell you is it's quite a lot of work to take all of that and then turn it into something more meaningful, both from the point of view of the transactions and the overall position size.

I think when it comes to transactions, part of the
objective, I think, with disclosure there is almost to
discourage the mere fact that you're requiring disclosure.
And that it will be a matter of public record then
discourages some of the activities that you're concerned
about.

On the other hand, the collection of the aggregate
or the net position can lead to a whole series of subsequent
additional questions. We certainly find that taking the raw
data and aggregating it in such a way that we address the "So
what?" question from our clients is not a trivial
undertaking.

So I think that it's certainly a very important
first step to giving the reassurance that the activities
you're talking about will at least be captured.

MR. GREENE: Let me comment from an issuer's
perspective, because we have, I think, come at it from a
slightly different perspective. We work very hard, as I
indicated in my remarks, to communicate with our investors
about issues about the company.

And when we find out about a rumor or concern about
some part of our company, at the next earnings call or an
analyst meeting or even an 8-K, if necessary, we will try to
address those issues.

Information about short selling that's coming
across the Tape is information we can use that indicates
something is going on, that maybe we need to find out what is
the issue that's behind it.

So from our perspective, we support having the
indicator in the consolidated Tape. We think it's a valuable
piece of information from an issuer perspective.

MR. BRIGAGLIANO: Can I ask if trades were marked
short, could or should there be a designation for "buy to
cover" trades to provide the counterpoint information so that
investors would understand whether a short might be
directional or not?

DR. ANGEL: Well, as an academic, I'd love to see
that data. But I'm concerned there may be a lot of
operational problems in that the person putting in the trade
may not necessarily know whether they are covering a short
position, so that I think it would lead to additional
compliance and enforcement burdens.

So I'd say, for now, start with the simple thing.
We already mark trades long or short. The exchange systems
already have the data internally. It's a very simple thing
to go forward and release that data publicly. To require
additional marking would be a much bigger step.

MR. BREHENY: Can I ask, a number of you commented
on the importance that you believe in leveling the playing
field between long and short position reporting. But if I
understand it correctly, in the U.K. the long report
threshold is at 3 percent, and the current proposal is to have the short positioning reporting at 0.5 percent.

So I'd ask you: If the Commission was to think of potentially extending the requirements that we have now for long reporting at 5 percent, 10 percent -- 10-day reporting, like in the 13D, and also thinking about 13F -- and as you know, 13Fs are filed by institutional investment managers as that term is defined in the Commission's rules -- could you see the reason why the thresholds and the timing and other disclosure may not -- may not make sense for those to mirror each other?

DR. ANGEL: Yes. There's a very good reason for asymmetric treatment of short selling versus long activity, and that is that the alleged allegations against short selling are that the short sellers have an incentive to destroy productive enterprises.

And since the purpose of our capital markets is to promote capital formation, to promote efficient risk-sharing, to promote enterprise, if somebody has an incentive to do something bad to our productive companies, that indicates a lower threshold for disclosure than for a long investor.

MR. MECANE: One thing I'd add, just conceptually, is that as a lot of people know, the logic for disclosing the long side was largely based on a determination that as someone moves towards voting control or, you know, towards
being able to exert influence over the company, that that's
something that should be -- that should be publicly
disclosed.

And so, you know, that exact logic doesn't
necessarily apply in this case. Similar to what Professor
Angel was saying, I think one perspective is that on the
short sale, we're largely worried about manipulative-type
behavior.

And so I think one way to separate the argument is,
similar to the logic the FSA is using but the numbers, I
think, need to be debated publicly, is there could be a
different level for private disclosure to the regulators, who
are primarily concerned with potential manipulative-type
behavior; and then public disclosure to investors, issuers,
et cetera, which might not be at as granular a level, but
makes the public disclosure more meaningful and more
applicable.

So one way to think about the debate is separating
those two pieces out because it is a different policy
objective than we necessarily had on the long sale, or with
insiders and so forth.

MR. BREHENY: I don't want to put Michael on the
spot. But if you could give us any gloss on how you came up
with the threshold, that would be helpful, too.

MR. TREIP: Well, I'll certainly come to that in
just a moment. But I would -- I would reiterate the sentiments that it is critical in our minds to look at the fundamental objectives of transparency for long versus transparency for short.

Certainly in Europe, the underlying philosophy for transparency for long positions is to shed light on voting rights. And the thinking is that that has to be referenced against the entire issued share capital.

Whereas if you're looking at the regulatory concerns that are posed by short selling, we're really looking at the potential impact that the short selling has on price movements and on trading.

And that really, in our mind, is referenced against a much lower figure. It's a reference against the daily volumes and so on. And that really brings us to how we came up with the thresholds.

And I have to say -- and this is probably not of comfort to everybody -- but there's as much art in this as there is science. I mean, it has to be said that that becomes even truer when you're looking at a one-size-fits-all regime for all types of stocks, and a regime, as is proposed within Europe, across all manner of different markets, some of which are very large, like our own, and some of which are really quite small and quite illiquid.

So it's a very difficult area. There's a high
degree of compromise. Our starting point in reaching the figures, certainly, in the U.K. was that we started off with a regime based on U.K. financial sector stocks. And we looked at the daily volumes and tried to come up with a figure that seemed to be a meaningful proportion of the daily volumes.

My recollection is that it was somewhere around the sort of 10 percent mark, that if your position represented something around 10 percent of the daily volumes, then that really could have an impact and cause a concern.

That was -- that was where we came out with U.K. financial sector stocks. It was also where we came out with -- came out in relation to rights issue stocks, which were just financial sector stocks but have an inherent vulnerability, obviously.

When we then looked at a broader scope regime, we felt that it was -- inevitably, we would need to be pushed up, that meaningful short positions in relation to non-financial stocks were going to be higher.

The share price and shorting in relation to financials, obviously, has a very direct link to consumer confidence, a much closer link than in relation to -- for financials has a much closer link than in relation to non-financials because ultimately you might have a run on a bank if people don't like the way it's going.
So we felt, inevitably, a broad regime would probably have to be higher. And 0.5 in the end was kind of where we came out with, as I say, perhaps as much art as science. We also recognized that once a regime has been in operation for a while, it may well be necessary to take another look at those thresholds to see whether they are producing the right type of information and are creating the right level of burden and not too much regulatory burden.

MR. CARRUTHERS: Michael, if I could just add a couple of points of information to that. I mean, it was mentioned on the Tape, at the moment, around 20 percent of all sales -- of all transactions are short sales. So that would certainly lead you to scale things potentially differently.

MR. GATES: I wanted to comment real quick on the...
professor's comments earlier. I have a different perception of the value of short selling. To me, short sellers aren't out to destroy value or to hurt the capital markets. Rather, my opinion is that they are a big part of the markets because they help reflect the true value of securities.

Since we've been managing money at TFS the last 12 years, the two -- there have been a lot of interesting times in the market. But two of the most interesting were the tech bubble, and the credit crisis and the real estate bubble. Both of those events have something in common in that they have the word "bubble" in their names.

So to me, short sellers are an important part to -- I guess I should say that long sellers are -- or long buyers have gotten more out of control than short sellers the last 12 years.

In addition, I think there are two important characteristics about short sales that differentiate them from long transactions. The first is that they have unlimited downside and only offer limited upside. That makes them a lot scarier than buying a security. For that reason, I think, most short sellers enter into transactions wary, and rightfully so.

The second is that it's easier to punish an over-zealous short seller. If a security is driven too low, an individual could come and purchase the company the following
day and drive the price up higher. It's harder to punish an
over-zealous purchaser. If a stock is -- pets.com is driven
up to huge multiples, there's not much you can do to properly
reflect its value.

And for that reason, I don't think that people who
buy securities -- the bubbles that are created are not as
easily pierced.

Mr. Greene: From our perspective, we see no reason
why the rules, disclosure rules for short selling, should be
any more lax than for long holders. You know, our
perspective, it's all information about the views people have
taken about the company. And it's information important to
the issuer, and it's important information for the investor,
eto.

So from our perspective, there ought to be at least
comparability between long and short positions.

Mr. Gitlin: Just getting back to the threshold
trigger question, I'd say at this stage I don't know if
anybody is basis point smart. But whether it's 25 or
50 basis points, I would say as Hong Kong and the U.K. and
CESR look at different threshold triggers, having something
that's globally aligned would probably make sense.

So if everyone is coming the line of 50 basis
points, not 25, I would say we don't have the basis right now
to have an opinion on that. But I think symmetry on a global
basis wherever possible is probably a good thing.

DR. ANGEL: I would like to correct a misconception. I think that most short selling is good and helpful to the market. But there are abuses that we do need to be aware of.

As far as symmetric treatment of long and short positions, I think there is a legitimate concern that disclosing every short position in an institutional-type filing might actually give away some important investment strategies.

There are two ways around that. One is de minimis exception. You know, if somebody is doing a pairs trading type strategy and they don't really want to give away how they're coming up with their pairs to trade, well, then, they're probably doing a lot of those, and there's probably not a large fraction of the stock involved. So a de minimis exception would deal with the "We don't want to reveal the strategy" problem.

The second way to deal with the "We don't want to reveal the strategy" problem is to allow on a case-by-case basis the SEC to make a decision as to whether, you know, a particular disclosure could be kept confidential for a period of time.

MR. BRIGAGLIANO: We've got one more minute. Jesse Greene, is there an important reason why issuers want or need
to know the identity of large short sellers in their securities?

MR. GREENE: Yes. Having the information there's a large short position out there doesn't help you find out what the problem is and what the concerns are about the company. A short position is essentially a bet against the company, a bet against its performance.

From our perspective, we want to go and talk to that particular short seller and find out what is his problem. And is there something that we haven't disclosed or something that we haven't described well that will help the marketplace understand us better?

So without the information about who the short seller is, we don't have the information we need to take that action.

MR. GITLIN: Jamie, one thing I would add to that is that gets along the beneficial ownership argument and discussion, which is probably -- we don't have enough time this week to discuss.

But I would suggest that that's one along the lines of what Jesse suggests, that if you imposed new regulations regarding short sale disclosure and you didn't have a beneficial ownership issue that you'd had to go along with that, you'd have short sellers hiding positions by shorting them on swap.
So I would highly suggest doing more and more work on beneficial ownership when it comes to reporting short sale disclosure.

MR. TREIP: Can I just chip in with an observation in relation to that? And I was quite encouraged by what Jesse said because a representation that has been made to us in the course of our consultation, if you can call it that, certainly, in Europe is that in fact a practice of requiring the identity of short sellers to be revealed publicly will actually close off the dialogue between short sellers and issuers, will actually stop those information flows; whereas what you're suggesting is possibly that that's not the case.

MR. GREENE: I don't see why it would. Certainly the short seller can always refuse to answer the question about what your concern -- our concern is. But it's certainly not going to stop us from asking the question, that's for sure. And it enables us to really target the question at the party that's taking the action.

MR. BRIGAGLIANO: Unless there are further questions from the Commission, we've now reached the end of today's roundtable discussion on short sale, pre-borrow, and disclosure requirements. On behalf of the Division of Trading and Markets, Division of Corporation Finance, and Division of Enforcement, I want to thank our panelists for their insights and candor.
I will now turn the program over to Chairman Schapiro for her closing remarks.

CHAIRMAN SCHAPIRO: Thank you very much, Jamie, Brian, and John for your great work today in moderating our final panel.

First, on behalf of myself and my colleagues on the Commission, I sincerely want to thank all of you for your participation today. We know you are all very busy people, and that you spent time preparing for and joining in this discussion. We appreciate that so many of you traveled to Washington for this event, including two of you who've come from as far as London, but from other locations, as well. And I want to thank my colleagues on the Commission for your helpful and insightful questions throughout these two days of roundtables.

Our decision to hold today's panel discussions is, I think, a reflection of our very deep commitment to approaching short selling issues in a thoughtful and deliberative manner, with the interests of investors foremost in our minds.

In that spirit, we are very committed to closely reviewing and weighing the potential merits of any additional short selling regulations such as pre-borrow or hard locate requirement or additional public or nonpublic disclosure requirements.
I think that today's conversation and discussion of these issues, with lots of opposing views, will be enormously valuable to us as we move forward and think about our next steps.

Today's panels particularly well complement, I think, the discussion we had yesterday about securities lending. And again, we're just so fortunate over the course of two days to have brought together so many experts.

Before we disband, I want to thank the key members of our staff who brought their skills and efforts to bear to make today's event possible. And they include Josephine Tao, Tory Crane, Liz Sandoe, Jeff Dinwoodie, David Bloom, Katrina Wilson, and Andrea Orr, and of course our moderators, who are sitting here with us, as well.

And once again, thank you all on the panel so much for your time and your assistance to us. Thank you.

(Applause.)

(Whereupon, at 12:26 p.m., the roundtable was concluded.)

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In the Matter of: SECURITIES LENDING & SHORT SALE
Witness: Roundtable
File Number: N/A
Date: Wednesday, September 30, 2009
Location: Washington, District of Columbia

This is to certify that I, David W. Baker (the undersigned), do hereby swear and affirm that the attached proceedings before the U.S. Securities and Exchange Commission were held according to the record and that this is the original, complete, true and accurate transcript that has been compared to the reporting or recording accomplished at the hearing.

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