UNITED STATES SECURITIES AND EXCHANGE COMMISSION

ROUNDTABLE TO DISCUSS SHORT SALE PRICE TESTS
AND SHORT SALE CIRCUIT BREAKERS

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Securities and Exchange Commission
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C O N T E N T S

P R O C E E D I N G S

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OPENING REMARKS

CHAIRMAN SCHAPIRO: Good morning. Welcome to the Securities and Exchange Commission's Roundtable on short selling. The Commission is grateful that so many have agreed to participate in today's meeting. I believe I speak for my colleagues on the Commission in saying that we look forward to the panel's comments, insights and recommendations on this very important subject.

As I noted at our recent open meeting where we proposed a variety of short sale restrictions, my brief tenure as chairman has seen the issue of short selling outpace any other in terms of the number of inquiries, suggestions and expressions of concern that we've received. Indeed, well before I arrived at the Commission, I heard from many investors on this issue.

We know that the practice of short selling evokes strong opinions from both its supporters and detractors. I've 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, and that is why we're here today.

On April 8th, we unanimously voted to propose two distinct approaches to short selling restrictions. One approach would impose a permanent, marketwide short sale price test while the other would impose temporary short selling restrictions upon individual securities during periods of severe declines in the prices of those securities. We proposed these amendments to Reg. SHO with the knowledge that any short selling restrictions must balance the goal of helping to prevent abusive short selling with the view that legitimate short selling can provide tangible benefits such as improved liquidity and pricing efficiency.

As we seek public comment on the proposed rules, we believe that this roundtable discussion will help in advancing the debate over short sale price tests and short sale circuit breakers. Throughout the day, we'll hear from three panels. Each panelist will take a few moments to share his or her thoughts on the issues being discussed, and when the opening statements are complete, the floor will be open to questions from the Commissioners.

The first panel will discuss the necessity and effectiveness of short sale price tests and short sale circuit breakers. The panelists will also comment on whether they believe a short sale price test or circuit breaker could help restore investor confidence which has been seriously eroded during the current financial crisis.

The second panel will take a closer look at the Commission's recent proposed amendments to Reg. SHO and evaluate the costs and benefits of the regulatory alternatives outlined in the release. The panelists will discuss the operational implications of these proposed rules and what impact they may have on market function and market quality if the Commission were to adopt them.

And the third panel will explore the empirical side of the debate over short sale restrictions. The panelists will discuss academic research on the subject of short selling and evaluate the recent proposals from a quantitative and academic perspective.

The panelists we will hear from today are leaders in their respective fields and represent a range of constituencies that includes issuers, financial services firm, self regulatory organizations, investors and the academic community. We are truly privileged to have them here, and we look forward to a spirited and substantive discussion.

I'll turn the meeting over now to Jamie Brigagliano, acting co-director of the Division of Trading and Markets who will introduce and moderate our panel. Thank you.

Jamie.

PANEL ONE - MARKET CHANGES AND INVESTOR CONFIDENCE

MR. BRIGAGLIANO: Thank you, Chairman Schapiro. We'll now begin the day's first panel titled "Investor

Confidence and Market Changes: Are short sale price tests or short sale circuit breakers necessary of effective? Following introductions, the panelists will each make a brief opening statement. Because we have a lot of information to cover in a relatively short time, we ask that panelists limit their opening statements to no more than three minutes. During your prepared remarks, Matt Sparkes over here will hold up a yellow card indicating when there's one minute remaining. Following the opening statements, as Chairman Schapiro said, we will engage in discussion with the Commission.

Before we begin, I'd like to welcome our distinguished panel. From left to right, Kevin Cronin is director of global equity trading for Invesco. Brian Conroy is senior vice president and head of global equity trading for Fidelity Research and Management Company, the investment management organizations of Fidelity Investments in Boston. Rick Ketchum is chairman and CEO of the Financial Industry Regulatory Authority, FINRA. He's also the chairman of the World Federation of Exchanges Regulatory Committee. John Kozak is senior vice president and chief financial officer of Park National Bank and Park National Corporation of Newark, Ohio. Dan Mathisson is managing director at Credit Suisse and is head of advanced execution services. Mike McAlevey is vice president of corporate securities and financial counsel at General Electric Corporation. He's a former Deputy Director of the Division of Corporation Finance at the SEC. And Justin Schack is vice president for market structure analysis at Rosenblatt Securities, an institutional agency brokerage in New York.

Kevin, would you like to start us off with your opening statement?

MR. CRONIN: Yes, thank you. Thanks for having me. Thank you, Chairman Schapiro and members of the Commission for the opportunity to speak here today.

I'm pleased to participate on behalf of Invesco in this roundtable to examine potential restrictions on short sales. Invesco is a leading independent global asset management firm with operations in 20 countries serving clients in over 100 countries with assets under management of approximately $350 billion. I should also mention that Invesco is a publicly traded company and is listed on the New York Stock Exchange.

I'm also pleased to participate in this discussion as the chairman of the Investment Company Institute's equity markets advisory committee to express the ICI's preliminary reviews on the SEC's proposals.

An efficient and effective trading environment is crucial to the mutual funds shareholders and to investors at large. We commend the SEC for its continued interest in addressing issues that may impact the fair and orderly operations of our interest in the securities markets and investor confidence in those markets.

Chairman Schapiro, as you noted yesterday in your speech, investors deserve careful examination of the issues surrounding short sales. To the extent that the additional restrictions on short selling can increase investor confidence in the markets, such restrictions should therefore be carefully considered. We share the view of many, including the SEC, that short selling provides needed benefits to the market, including playing an important role in providing market liquidity and in price discovery. For this reason, we believe that legitimate and lawful short selling must be allowed to continue.

It is possible, however, for market participants to use short selling as a vehicle to illegally manipulate the prices of stocks to facilitate or to facilitate other market abuses. Those practices must be stopped.

Several of the SEC's actions to date already have made great strides in this area, particularly efforts to reduce fails to deliver to reduce the impact of naked short selling. In considering the proposed restrictions, the SEC faces a difficult dilemma. It is unclear from what available empirical data whether any of the proposals would have had increased investor confidence -- would have increased investor confidence or alleviated any of the unprecedented market conditions of the past 18 months. Ideally, market forces would address concerns relating to short selling and there would be no need for further restrictions.

We recognize, however, that the impairment of investor confidence may dictate the need for some form of regulatory response to recent market events. While a member of the ICI's including Invesco are still examining the possible impact of the SEC's alternative proposals, we believe that the Commission must proceed deliberately as it considered the consequences of the proposals for investors. As the Commission is aware, we are trading in very, very different market circumstance and conditions than we were just a few years ago.

The SEC must also balance the potential benefits to proposed regulation with the costs of the rules. Finally, it's critical that any new short sale regulations have a robust inspection and enforcement regime attached that will provide investors with confidence that violators and abusers of these regulations will be detected and punished.

I think it is fair to say that there is no absolute consensus among mutual funds on the optimal course of action relating to the proposals. Invesco, along with many of our peers, believe that immediate SEC action is not warranted at the very least until the impact of the options before us are considered further. If the SEC determines that it must move forward, Invesco at this time believes that a circuit breaker imposing the proposed modified uptick rule would be the least damaging to the markets.

Our fund group believes that the SEC other -- I should say other fund groups believe that the SEC should adopt a proposed modified uptick rule on a permanent basis or possibly through a circuit breaker that when triggered would impose the modified uptick rule. Either way, the parameters and scope of any SEC action must be further delineated to ensure that it does not negatively impact investors. For example, by reducing market liquidity, you're harming price discovery.

I would be remiss if I did not spend a moment on the Commission's interim final temporary rule which requires institutional investment managers to report to the Commission certain information concerning their short sales and short positions. While we strongly support the Commission's need to obtain information to address concerns relating to abusive and manipulative short selling, we strongly urge that the SEC continue to adequately protect the confidentiality of this information to prevent front-running of the fund's security positions. If a public disclosure regime is to be established, we believe it is best achieved by the SEC requiring disclosure of a short position on a periodic but sufficiently delayed basis.

Finally, speaking from the standpoint of an asset management firm with interconnected trading desks in several locations around the world, I urge the Commission to work closely with foreign regulators to create consistent and sensible cross-border regulations in this area.

Invesco and the rest of the members of the ICI look forward to working with the Commission as it continues to examine the options for any additional short selling restrictions and their impact on investors and to expressing our final recommendations in the ICI's comment letter next month.

I thank the Commission, again, for organizing this roundtable. I look forward to answering your questions.

MR. BRIGAGLIANO: Thank you, Kevin.

Brian?

MR. CONROY: Good morning. As noted, my name is Brian Conroy, and I am the head of global trading at Fidelity Investments. We're at the end of the first quarter of 2009. We had about 2.5 trillion in assets under management and administration, more than 450 billion of which were managed equities. These assets represent the cumulative investments in over 77 million customer accounts for individuals, 401(k) participants and institutions.

As a market leader, we believe it is important to engage with the policy makers to ensure that the appropriate balance is struck between regulatory oversight and robust market discipline. As a result, we appreciate the Commission holding this hearing and welcome the opportunity to participate.

Less than 1 percent of the assets Fidelity managed are in long-short strategies, so while I worked for 15 years in the broker-dealer community and three years at a large hedge fund, I generally come at this topic with the frame of reference of a long rather than short investor. At its core, our trading desks' fundamental responsibility is to implement the investment ideas of our portfolio managers by trading securities as efficiently as possible. To do that, we seek to participate in and facilitate efficient, liquid and orderly capital markets.

Efficient markets benefit our shareholders in the form of lower trading costs which ultimately improve performance. As a stakeholder in our capital markets and as a fiduciary for millions of investors, it is important to Fidelity that the regulatory structure governing the U.S. trading market promotes rather than impedes liquidity, transparency and pricing efficiency.

At Fidelity, we believe the vast majority of the time short selling helps create a more liquid, transparent and efficient trading market without creating any harm in the integrity of the market. At the time, we recognize the need to curb abusive short selling practices such as naked short selling which we believe can be accomplished with the enforcement of existing regulations, including the rules targeting these practices that were adopted by the Commission in the fall of 2008.

As the SEC considers whether the permanent reinstatement of some form of uptick rule or additional short selling restrictions are necessary, we encourage the Commission to consider two important points. First, despite the recent upheaval, the U.S. equity market functions as the most competitive, liquid and efficient market in the world. Daily trading volume is the largest, and spread costs are the lowest of any global equity market. Second, in the last eight months, we've experienced a virtually unprecedented equity market disruption. In reacting to these extreme -- extremely unusual recent market events, we encourage you to act cautiously to ensure no damage is done to the robust equity market that currently exists when this serves the interests of so many investors.

In addition, we encourage the Commission to review data relating to the existing and recently repealed rules concerning short selling before determining that any additional regulatory action in this area is necessary. After reviewing the data ourselves, Fidelity believes that the best way to protect investors and maintain the benefits of an open, liquid and transparent market is for the Commission to not adopt any of the proposal it has put up for comment.

If in the interest of bolstering investor confidence, however, the Commissioner -- the Commission believes some form of regulation is required, we believe that the Commission should implement a remedy that addresses the aberrant markets that occur from time to time rather than posing a potentially costly regulatory regime that could burden the market on a daily basis and ultimately increase trading costs for our investors which is certainly not in their interest. As a result, Fidelity believes that at most, the circuit breaker option should be the only proposals under consideration.

Thank you for inviting me. I look forward to participating in the discussion.

MR. BRIGAGLIANO: All right. Rick Ketchum.

MR. KETCHUM: Chairman Schapiro and members of the Commission, thank you very much for having me here. It's an honor to participate in this critical issue.

I'd like to make two points at the beginning. First, certainly, this is an area that FINRA as an organization fundamentally focused on investor protection cares a great deal about as well as its responsibilities to help enforce whatever you end up adopting. So we have a great deal of concern also with respect to the structure of any proposal that the Commission does move ahead with.

Secondly, let me just give as a disclosure that this is not an issue that our board has considered at this point. So the views I'm expressing are my own and when other people convince me differently, I'll figure out a way to back away from them as well.

I'd like to just make a few basic points in working through my thinking with care to note the time and try to avoid repetition. First of which is I have believed and continue to believe that the Commission has been correct in focusing its primary regulatory focus with respect to short sale on the areas that Reg. SHO and the interim rules do apply to with respect to locate and settlement. I think it's remarkable how effectively the industry has been able to comply with the tougher rules that have been in place now for months. It is the area, I think, that provides the greatest appropriate balance from the standpoint of protection.

I will make a confession, however, though. I was entirely supportive of the Commission's position with respect to completely rescinding the short sell rule. I have been marked by the trading markets that occurred last fall, and I believe that they demonstrate the appropriateness of the

Commission at least seriously considering possible actions. But I think in looking at those actions one has to define what you're attempting to address and what facts really, really exist.

I do believe that the trading in September and October demonstrated certain truths that we've all known but perhaps more dramatically than we've seen. First, it continues to be a fact that the world is net long and the world reacts to dramatic down movements differently than it reacts to dramatic up movements. Secondly, there are financing issues with respect to dramatic down movements that are different in scope and in many ways more predictable than with respect to upwards movements. Third, thinking of doing anything in here without effective jurisdiction with respect to derivatives in the over-the-counter area, particularly credit swaps is probably futile and should be carefully looked at in anything you consider.

Finally, if regulatory action is taken, as I think probably it may well be justified, it should be focused on those areas of concerns from the standpoint of predictability and exposure of the marketplace. In simplest terms, the market is not usually exposed and companies are not usually exposed and people are not usually put into an environment where it's reasonably predictable that there will be a cascading failing as a result of concerns with respect to either the company or with respect to intermediaries.

So if there is to be regulation, I believe strongly it should be focused in the circuit breaker side of the activity. In addition, quotes are certainly better than trades. Speaking as a regulator, I don't want to be involved in the situation of worrying about who's gaming with respect to creating upticks, and I don't think it makes a great deal of sense.

Third, I think that while I would strongly recommend you not have a rule that's in place all the time because I think it creates burdens without any particular benefit, I do think that the present proposal operating circuit breakers with respect to just the rest of the day probably is ineffective just as price limits were ineffective in the past with respect to Asian markets. So if I were doing something, I would, one, focus on circuit breakers. Second, when I speak circuit breakers, I really -- I would avoid prohibitions if at all possible anytime. I would only focus on quote-based tests. Third, I would think of at least giving the flexibility to consider for more than the rest of the day because I don't think otherwise you've changed really the perspective of what's going on.

And I believe that if all those things done and the last piece would be that whatever the Commission does, it should set out the tools and require the industry to be in place to respond to the various things you require and not have additional tools in your tool bag. You should avoid surprises. Whatever alternatives you have should be built into these rules, should not be part of emergency rules and should operate from that standpoint.

And with that, thank you very much for this opportunity to be here.

MR. BRIGAGLIANO: Thank you, Rick.

John Kozak.

MR. KOZAK: Good morning. My name is John Kozak. I'm the chief financial officer for Park National Corporation, and again, I'm delighted to be here and thanks for inviting us. We're headquartered in Newark, Ohio. We're a 7-billion dollar bank holding company that owns and operates two banks. One bank, our lead bank, is $6 billion in size with 12 banking divisions, and it operates 127 offices in Ohio. Vision Bank is headquartered in Panama City, Florida, and it's 900 million in assets with 18 offices across the Panhandle of Florida and into Alabama.

These banks are traditional community commercial banks. They offer deposits, loans, cash management, retirement and wealth management products and services to their local communities. Park is traded on the New York Stock Exchange, the AMEX part of the New York Stock Exchange. We have close to 14 million shares outstanding and a market capitalization of about 925 million. We're largely retail owned. Seventy percent of our shareholders are retail, 30 percent institutional.

I'm pleased to be here today representing the American Bankers Association. The ABA brings together banks of all sizes and charters into one association. ABA works to enhance the competitiveness of the nation's banking industry and strengthen America's economy and communities. Its members, the majority of which are banks with less than 125 million in assets, represent over 95 percent of the industry's 13.6 trillion in assets. Pretty amazing, 95 percent all in one trade association.

The ABA recognizes that short selling can be a legitimate and important financial tool operating as a mechanism for generating market liquidity, securing price discovery and fostering corporate accountability and responsibility. That said, many ABA members both large and small, believe that some short sellers may be taking advantage of the uptick rule's absence and as a result, banks' stocks may be experiencing excess downward price pressure. The price volatility generated by this short selling activity can be different than the underlying fundamentals of these banks. These disruptions are especially problematic for banks as our customers frequently and incorrectly equate significant drops in bank stock prices with safety of bank deposits.

Our markets today are much different than July 2007 when we were working -- the Commission was working on determining whether to eliminate the uptick rule. Another way to say that is, boy, how can you test that unless you go through a bear market? And so I would be a proponent of re-instating some form of the uptick rule.

The Commission has proposed two approaches, two restrictions on short selling: a price test that would apply on a marketwide and permanent basis or a circuit breaker which would apply only to a particular security during severe market declines. The ABA is on record in support of reinstating the uptick rule in some format.

Park National supports a price test based on the national best bid. We think that that would be easier to implement and more practical given the changes in today's market and would be fine. Why don't we test that and put that into place?

On the subject of today's roundtable, the ABA does believe that more should be done to restore investor confidence in our markets. First, the Commission should make permanent Rule 204(T) with its locate and hard closeout requirements which have had a beneficial impact on short interest volumes.

I provided you with a handout that really shows that in detail, and really the point of that handout was to show you that on September 17th when you instated the emergency rule, we had an immediate and significant impact on our volume. Our short interest at Park was at 1.6 million shares, and in two weeks, it went down not in orderly fashion by a couple hundred thousand shares. Obviously, folks that, you know, had probably sold the shot naked, sold our stock naked. And their price went up 32 percent. Okay? Things like that bother investor confidence. That's not a good thing.

So from being in, you know, the Midwest working at a small bank, that's not a good thing at all. We certainly lose investor confidence when things like that happen. So I've included data for you to kind of look and see what our short interest volume has been over a period of time. But there's times when our stock has gone down in price significantly without us announcing any news. And again, we have a retail shareholder base of 70 percent, and the volume is being dictated by changes in the short positions. We're not for that. So I'd like to say that.

Continuing on, the ABA also would say second, more aggressive enforcement of short selling regulations should be undertaken in order to root out manipulative short selling activities. Third, the Commission should consider whether there is some manner in which short sales information could be made available to the public on a delayed basis.

Overall, again, I'm thrilled to be here representing the ABA and thanks for having me.

MR. BRIGAGLIANO: Thank you, John.

Dan Mathisson.

MR. MATHISSON: All right. Thank you for having me. I run electronic trading at Credit Suisse. To date, we've been responsible for approximately 11 percent of U.S. equity volume.

There's a silver lining in the events that we saw in the fall of 2008 in that during the 14-day short sale ban, we had an opportunity to look at what the world would look like if there was no shorting allowed at all. And it wasn't a pretty world. We saw bid-ask spreads dramatically widen. We saw volume dramatically decline, and we saw volatility shoot up.

Now, a lot of people don't really get it. You know, out on Main Street, they don't understand why taking away shorting does all this damage to the market. And the fact is that almost no professional traders are net short. Almost all professional traders run long-short strategies.

In August of 2008 right before the credit crisis, the Credit Suisse Tremont index showed 0.6 percent of hedge funds were net short. All right. So in other words, almost no funds are net short. They're always long short. For every 100 shares they're selling, they're buying 100 shares in something else. What this means is that when you restrict short selling whether by banning it or just by slowing it down, you're also -- you're also taking buys or slowing down buys on the other side, almost in a one to one ratio. For every 100 shares you pull out on the sell side, you pull out 100 shares on the buy side. All right? So if you stop the shorting in one bank, you've stopped somebody from buying 100 shares of some other bank. And that's the reality of how the market works today.

Taking this into account, we believe that restricting shorting is just going to pull both buyers and sellers out of the market as we saw during the ban, resulting in less liquid markets. And for that reason, we think any of the all stocks all the time rules -- you know the up bid or what we call uptick classic are disastrous policy in that what they do is -- is they -- we look at those as essentially chemotherapy for the market in that what you are doing is in order to attack a few cancerous cell within the marketplace, you are sickening the entire market body and you're causing damaging side effects.

On the other hand, circuit breakers are highly targeted to just the problem stocks. Circuit breakers go in and essentially they're more like surgery where you go, you remove just the diseased cells while leaving the rest of the body untouched and unharmed. Within the circuit breakers, we think that the halt is the best. We think that that would be the most effective in that it gives management an actual breathing space away from shorts, although it is worth pointing out that like in all the restrictions but particularly in the halt model, exemptions for hedge derivatives, ETF and convertibles traders are absolutely critical.

Another reason that we like the circuit breaker halt model is it's much, much cheaper and easier to implement, understanding how technology works within Wall Street. We estimate that within the broker-dealer side, any of the rules that require centralization of data and sequencing of data, whether it's sequencing ticks or bids is irrelevant. If you have to sequence the data, it becomes a huge project and it's something Wall Street doesn't currently do. And we estimate it would take approximately 12 months for a bulge bracket broker-dealer like ourselves to implement a tick or a bid rule. On the other hand, we believe a circuit breaker that doesn't require sequencing of bids or ticks would take approximately three months for us to implement.

So for all these purposes, we believe that circuit breaker halt with appropriate exemptions is the easiest to implement, is the least damaging to liquidity and would be the most effective at giving management breathing space and for these purposes, we support the circuit breaker with halt.

MR. BRIGAGLIANO: Thank you, Dan.

Mike McAlevey.

MR. McALEVEY: Thank you for the opportunity to participate in the panel today. I'm pleased to speak on behalf of General Electric.

I should say at the outset that none of my remarks should be understood to oppose short selling generally. While short selling serves functions in the marketplace like price discovery and liquidity, it should not be allowed to be misused by some professional traders to take advantage of the shareholders of public companies by driving the prices of their securities to abnormally low levels.

My remarks today are aimed at helping the Commission reach a better balance among market functions and other important considerations like investor confidence in the fairness of financial markets, prevention of manipulative or abusive practices and transparency. Short selling should simply not be allowed to be used solely or in connection with other actions to improperly destroy the financial reputation of companies and create systemic risk in the global financial system.

Numerous investors both large and small have brought to our attention concerns about large, well capitalized and opaque trading strategies that have a significant effect on stock prices, abusive short selling including naked short selling and false and misleading rumormongering sometimes used in connection with these strategies.

The absence of some regulatory response to these types of concerns creates a significant confidence issue, in our view. We support the Commission imposing some form of price test or circuit breaker test to help restore this confidence. Among the tests that the Commission is considering, although it's close, we would support a marketwide permanent short sell test based on the national best bid. And we think that this is a better test for a number of reasons, many of which are identified in the Commission's proposing release: concern about stigmatization of stocks that have hit the breaker, the possibility of the magnet effect which increases downward pressure on stocks if the value approaches the breaker level and in addition, that it may allow the manipulative trading strategies to continue until the breaker limit is actually hit.

We think that the bid is better than the sale price because the consolidated bid is updated and reported more frequently than trade data and it is widely regarded as a more accurate reflection of the current price of the security.

Equally important, I don't think that we can talk about reforms in the area of the uptick rule without also saying a little bit about disclosure. In addition to what I've already talked about, I would urge the Commission to think seriously about some additional disclosures, either through amendments to Form SH or in some other way. First, to consider requiring disclosure about the timing and amount of any long position or an economically short position that a reporting person has established in a reference entity's credit default swaps. Large short sales accompanied by CDS purchases are a powerful tool for manipulative conduct because of the responsiveness of equity prices to changes in CDS spreads. This combined trading strategy should be subject to as rapid reporting as possible in order to ensure that the marketplace is fully informed and participates, can take the short sale CDS relationship into account in their investing decisions.

Second, the Commission should consider imposing disclosure requirements about the timing and type of derivative positions that are the equivalent of a short position in the stock. And third, without getting into motive, I think that the Commission should seriously consider imposing disclosure requirements of whether a reporting person directly or indirectly through any contract arrangement or understanding has or shares a short position in the stock, a short equivalent position in the stock or a long position in the CDS. If the Commission determines that it doesn't already have the authority to impose any of these disclosure requirements, I would ask the Commission to seek it from Congress.

Thanks.

MR. BRIGAGLIANO: Thank you, Mike.

Now, Justin Schack to wrap up the opening statements.

MR. SCHACK: Thank you and good morning. Rosenblatt Securities is pleased and honored to participate in this roundtable. Rosenblatt executes trades for managers of mutual funds, pension funds, hedge funds and other investment firms. Institutions such as these manage the vast majority of U.S. retail investors' equity assets. The Investment Company Institute, for example, estimates that some $3.3 trillion is currently invested in equity mutual funds alone.

Changes to market structure arising from regulation often profoundly affect the ability of these institutions to efficiently execute securities transactions. This can in turn impair their investment returns and by extension, damage the capital formation process and the health of our economy. It is therefore vitally important to consider whether any proposed short sale regulations will bring demonstrable benefits that will outweigh other potential adverse impact.

Rosenblatt also analyzes and advises clients about market structure. In this role, we have gained a unique perspective on how competitive dynamics and regulation affect market quality. Of particular importance to today's discussion, we believe, is the role played by so-called high frequency traders. We estimate that high-frequency firms account for as much as two-thirds of consolidated U.S. equity volume. These firms have become the market's new primary liquidity providers, supplanting NYSE specialists and traditional NASDAQ market makers.

High-frequency firms and other market participants regularly sell securities short not to express a fundamental view but rather as part of complex, computer-driven strategies, most of which involve corresponding or related long positions in the same or comparable securities. We believe that the reinstatement of a price test for short sales would cause high-frequency market makers to curtail their trading activity by as much as 20 percent. This would result in wider spreads, less liquidity and higher net transaction costs for the investing public.

To be sure, other forms of short selling can be abusive or manipulative. Naked short selling can contribute to artificially large decreases in the prices of securities. However, the Commission's recently adopted rules regarding fails to deliver appear to have effectively neutralized naked shorting as a market problem.

Most importantly, we must take care to ensure that politics do not get in the way of an intellectually honest assessment of this issue. Congress is pressing for action to do something to boost investor confidence. However, considering the recent equity market rally and the growing sentiment that the worst of the crisis is behind us, the need for an immediate boost of confidence does not appear acute at this time. We believe that imposing regulations that could do more harm than good simply for optics' sake is not the right thing to do for our markets and for our economy, especially during a time of crisis.

If, however, the Commission determines that new restrictions are in order, we believe that a price test triggered by circuit breakers would have the fewest adverse effects on market quality. And we strongly urge the Commission to consider exemptions to any new short sale restrictions that would permit high-frequency traders and other market makers to continue to provide the same robust level of liquidity to the market that they do today.

Once again, thank you for seeking the opinions of market participants regarding this highly charged and complex issue and for the opportunity to participate today.

MR. BRIGAGLIANO: Thank you, Justin.

And, panelists, we deeply appreciate the very thoughtful statements that you've made. And now, we'll take questions from the Commission.

COMMISSIONER CASEY: Good morning. And I want to thank all of you for your very good statements. I'd like to start off with asking you all to give us your best view of the effectiveness of the old uptick rule. I know Rick and others have spoke a little bit about the amount of focused study that the Commission engaged in in looking not just internally at some of the analysis through a pilot program but also I think 13 other empirical studies and data that we've collected that ultimately supported the Commission's decision to remove the uptick rule.

But I'm really interested in, one, whether or not you believe the uptick was effective given what we know about the changes in the function and structure of our marketplace over the past several years and then if you don't believe it was effective, then why do you think there were so many calls for us to reinstate the old rule? Begging the question of the fact that we're actually proposing different price tests here that would be effective in this marketplace. And if that is the case that it wasn't effective and folks were calling for us to reinstate it knowing that it wasn't effective, how would that actually increase investor confidence? And any data or analysis you can point to would be helpful.

MR. CRONIN: I'm sure glad I'm sitting at this part of the table.

Let me see, where to start with that one? I think it's very important to understand the context of the uptick rule both in its 1939 to 2007 state and what it would have meant to have been in place today.

Clearly, I think any discussion about that has to take into consideration the fact that the market structure has changed dramatically in the last two years. There are now today in the U.S. over 40-something destinations that people like Brian and I can send our order flow to. So I don't think personally that the regime of enforcement was ever particular strong with respect to the uptick rule, but I think it would be nearly impossible given the state of development of the financial markets today.

So I think why people would come to you and say let's repeal this, let's be honest. We're all irritated and aggravated that the markets had the negative move that it has. Many of us who do this for a living understand it, but, you know, sort of at the emotional level, it still bothers us.

But if there's something that I've learned over the past 20 years in this business, it's this: The best decisions I make on behalf of our clients, shareholders, et cetera, is ones that are based on facts, not ones that are based on emotion. And my suspicion is that the emotion of this makes it very easy for anybody to identify either short sellers or the promulgation of a new rule against short sellers as this elixir that cures all the things that are ill in this marketplace.

I submit to you that this would not cure all ills, that bringing back in particular the uptick rule based on the last sale would not be effective, could not be, I think, governed and regulated and enforced appropriately to give anybody at any level confidence. So to bring that back, how would this discussion or what's the sort of virtue of discussion about this process, bringing the confidence to the investor? And I hope it's this. People realize that we really care about this.

Interest in this issue is going to wax and wane, we understand, based on where the Dow closes on a particular day. To the extent that things have been better for the past couple of weeks -- make it seven or eight now -- probably is not as salient as it was, you know, six, seven months ago, certainly in November of last year and more recently in March of this year. But as their interest wanes, our interest remains. We want to create structure that facilitates the long-term advancement and development of efficient, you know, very sort of open and, you know, transparent market structure that by nature of its implementation has regulation in a limited perspective, but the regulation that's there is enforced and it's enforced with vigor.

To the extent that 204(T) is made permanent, to the extent that 10b-21 is really enforced and teeth are put on that and it's really sort of held to the level of standard that it should be, I think a lot of the things that need to be in place for this short selling sort of problem that we have today or at least had recently can be addressed. That's my perception of the issue.

MR. CONROY: Kevin, I would say you did pretty well for leading off there, by the way.

So the first question, Commissioner, I believe was do you think -- do we think the uptick rule is effective. And I would just point towards the pilot program and the data that came out a few years ago during -- I think the quote was "normal market conditions." That was there no evidence that there was an effect.

And I think we have to remember in the context of the 1933 market in which the original uptick rule was put in place was a very different market than the one we're in today. I think it was about ten years ago the New York Stock Exchange, volume of New York Stock Exchange listed stocks first dropped below 90 percent. Very little of the volume was done electronically and a large -- I think it was 15 percent of the volume was done by New York Stock Exchange specialist firms. And if we all recall, that was a day and age where there were two places to buy and sell stocks. There was essentially the NASDAQ marketplace and the New York Stock Exchange marketplace. And with respect to the New York Stock Exchange, stocks traded by human beings who stood around a post.

I don't need to remind anybody by looking at CNBC in the visitor's lounge that that rarely takes place today. And to roll back to a time that had regulations around a very different marketplace, I think is a dangerous thing for us as a industry to consider. And as some of my colleagues on the panel pointed out, with 70 or so percent of the market liquidity being provided by high-frequency trading firms, there is a call for the realization that the marketplace of today is, in fact, different than it was ten years ago.

I think why would investors be clamoring for a go-back to earlier times, I think it's because of the complexity of the issue. I think it is the topic du jour. It is something that people have heard about. It is something that is potentially not as well understood on Main Street as it is in other places in the industry. And I'm sure that if -- you know, I may have an opinion on the use of nuclear power as a clean energy source, but I couldn't speak intelligently about its safety.

So I think with respect to what the Commission's doing in holding this roundtable and asking for input from market participants and academics, I applaud you for your research and your time. Thank you.

MR. KETCHUM: I think, Commissioner, that's absolutely the right question. I think it's -- and I agree with virtually everything said before with respect to how the market's changed, how much of this perception relates to electronic trading and the rest.

But I think actually to answer the question fairly, you have to define what you mean by effective. If you mean by effective did the tick test have an impact in people engaging in substantial short selling, did the tick test have an impact with respect to controlling volatility and the rest? I don't see any academic indications of that.

If you define -- if you sort of identify reflecting back on last fall and define quite narrowly, does a tick test have some investor confidence or active trader confidence even with respect to in a very short period of time in exceptional circumstances as to whether shorts can engage in consecutively hitting bids on a continuous basis without break when there -- when essentially most buy interest has withdrawn from the market, I guess my answer to that question, I think that's, to me, the only correct question because I don't think you should regulate beyond that, and I don't know. But I think that there -- I think as reflected here to some degree, I think there is some likelihood that there is an encouragement for withdrawal from a buy side because of the concern of the ability for short sale to take the market down. And I can't measure that, and I certainly can't demonstrate it. I do believe in those circumstances activity and the cause and effect of consecutive hitting of the quotes is somewhat more predictable as was made by Mike, a point made very well, I thought, by Michael and it's worth considering.

But I that's, to me, the only question, whether there is some social usefulness in providing some comfort to the market that shorts alone can't engage in continuous quote hitting on an uncontrolled basis. Having said all that, the tick test is a lousy way to do that, a particularly lousy way to do that when any tick no matter what the size can allow for any trade. That simply makes no sense, and clearly, your proposals are much better than that.

MR. KOZAK: On this panel, I think I kind of represent Main Street. You know, I live in a community that, you know, has 40,000 people, you know, et cetera. Very much in favor of a new uptick rule being reinstated. You know, national best bid, that's absolutely fine. But in more thinly traded stocks, to say that an uptick rule doesn't have an impact is absolutely, in my opinion, ridiculous.

You know, days to cover the short position in our stock has been high as 40 days. Does that make any sense? Absolutely no. So volume in the short interest position can absolutely influence our price substantially, and that doesn't make any sense. There should be, in our opinion, for stocks that aren't as liquid as, you know, national-market-type stocks, absolutely we need an uptick rule.

Then the other thing, my other point would be, yes, everybody says you did a great job on the study -- I applaud you for that -- back in 2007, but, you know, when do you want an uptick rule? You want it in a bear market. Did we study it in a bear market? Well, we didn't have a bear market at the time, but that would be my other comment. Thank you.

CHAIRMAN SCHAPIRO: Could I just jump in, Jamie, if you don't mind?

I recognize that we don't want to react to every market up and down, but we do want to make sure we're being highly responsive to sort of fundamental changes in our market. And this discussion leads me to wonder whether even if the old uptick rule perhaps was -- had become pretty ineffective because of market structure changes, because of high-frequency traders that you all talked about changes and therefore, the old uptick rule was perhaps not doing what we had hoped it would do, doesn't that suggest that maybe it should have been replaced with something else that was more effective in the new market structure? And that that's really what we're really trying to explore here is given all of these other changes, what might replace the old uptick rule or what else might act as a governor on abusive short selling in these new markets with high-frequency traders, with 40 different places to send your orders, with a great amount of fragmentation that we have today in the technology that allows for this tremendous speed of execution.

MR. MATHISSON: High-frequency trading, just to be clear about it, typically, the people who are doing that go home flat at night. So for every -- so, you know, so they're not the guys who are causing, you know, John's stock to have 40 days of short interest outstanding. They're buying it back the same day that they're shorting it.

CHAIRMAN SCHAPIRO: I'm not trying to blame anybody. All I'm trying to say is we've had all these changes since the old uptick rule went away. To me, that doesn't necessarily argue that you don't need something. It just perhaps argues that you don't need the old uptick rule back. That was the only point I was trying to inquire about.

MR. MATHISSON: To answer both of those questions, both of that as well Commissioner Casey's earlier question, you know, I believe the uptick rule was completely ineffective, particularly since decimalization. It slowed you down slightly to put on your positions. It also allowed you to put out -- you were able to show big orders and then long sellers would jump ahead and hit the bid. It didn't necessarily change the price or lead to any upward price bias which was, I guess, what people are trying to get to. So we believe the rule was ineffective. We think that a circuit breaker with trading halt could potentially be an effective replacement that would fit in nicely with today's market.

MR. McALEVEY: If I could just -- I think it's going to be difficult to prove one way or the other whether the reinstitution of something is going to be effective at addressing some of these abuses unless we actually try it either on a pilot basis or some other temporary basis.

But it seems to me just as a matter of logic and intuition that imposing some sort of marketwide test based on the consolidated best bid is going to have some slowing effect on very rapid declines in securities, likewise would a circuit breaker test.

Addressing this issue of investor confidence, I don't -- I would encourage the Commission to look holistically at this issue because whatever the Commission decides to do with respect to the uptick test, I think that there are a number of other pieces of the puzzle that need to come into place in order to restore investor confidence in the marketplace. None of them alone are probably going to be effective. Maybe all of them together may get closer to being effective at addressing concerns.

But in terms of academic studies and statistical analyses and economic analyses, when you step back and you just talk to the long investors in these companies -- and I'm not talking about small retail investors. I'm talking about very significant large institutional investors. The observation can replace statistical and academic analysis, and the observation is with respect to some companies that there has been rapid deterioration in stock price accompanied by a number of other things and then suddenly a rapid restoration of value. And that smacks of something going on other than just ordinary operating markets. Thanks.

MR. SCHACK: I agree with much of what's been said about whether the uptick rule was effective, why people are asking for it to come back. I won't repeat some of those arguments.

I think we need to ask ourselves the question what is the problem we're trying to solve here, when can short selling be abusive and is, you know, shorting on a down tick or a down bid, does that constitute abuse? Does naked short selling constitute abuse? I think it's pretty clear that naked shorting is abusive. You shouldn't be able to sell, you know, more than the shares that actually exist. And the Commission has done a good bit to make sure that that doesn't happen anymore.

My worry is that when you think about market quality, you think about firms like Brian's and Kevin's being able to put on positions for folks in small-town America who live in those 30,000, 40,000 population towns who are saving for college or retirement through mutual funds or through a pension fund that has money invested with a long-short hedge fund. What is going to be the impact on market quality if we limit short selling and the folks who are providing liquidity in this market now either -- they won't cease to do that, but they will do it in a shrunken form. And that will make it a lot more difficult for firms like Brian's and Kevin's to get good returns for Main Street investors.

MR. CRONIN: And I would just add again, I don't think that we can minimize the intersection of all the events that are taking place today. Again, market structure has changed precipitously. We have volatility that's been introduced in the market that we hadn't had for some time. Certainly, we've had problems with financial companies and the economic cycle in general. And all these things are confluencing at one singular time which we really haven't ever seen the planets align like this, certainly in many generations.

And so to the extent that that's happening, it makes it very difficult for any of us to say to you, Chairman

Schapiro, and any of the other Commissioners, ah-ha, if you just did this, we would find this magic answer and we could all go home early today. The fact of the matter is that because we're in the infancy stage of development of a very complicated, complex U.S. financial market today, I can't say for sure what effect any of the rules would have either intended or unintended. And that's my concern.

I look at what I believe is the aberrant, you know, bad, egregious behavior in the marketplace, and it continues to seem to me to fall in two dimensions. One is this naked short selling that we've been talking about for some time which I think has been effectively dealt with through 204T which needs to made permanent. The other is this manipulative short selling type which does include, as the gentleman from GE suggests, CDs, CDSs and other equity swaps and different ways to represent similar exposure to short selling.

So in order to effectively address that, you do have some rules on your book that give some teeth to enforcement of those particular dimensions of anti-fraud and manipulation. But clearly, there needs to be another step to that which is regulating the other markets. If I had more clarity on that, then I would say to you I would be comfortable really addressing those particular dimensions of the short selling market with those steps.

I don't view the things that these external liquidity providers and 99 percent of the other people who are laying out shorts in a given day as egregious. Generally, it's hedging behavior. Generally, it's associated with some of our colleagues saying other buys and other things that go on, and those things promote liquidity and effectiveness and transparency. Those are good things for the marketplace.

If we got to the point where we were absolutely certain that something had to be done, then I'd say let's take an incremental approach, let's really study the issue just as we did back in 2003 and '4 with Reg. SHO and all the different iterations that we had with that and make sure that we don't come up with something that makes the current condition, the 95 percent of the time that we're participating in the market, beholden to that 2 or 5 percent time of the market that we're really concerned about. I just think that's the bad way to approach this problem.

MR. BRIGAGLIANO: Commissioner Walter. You had a question?

COMMISSIONER WALTER: Thank you, Jamie.

As I listen to you, all of you speak, perhaps this is a Pollyannish view, but I hear a tension between two positive things: a desire to have the price of a particular security be what it should be and really represent the value of the underlying company and a desire not to interfere with broader trading strategies which involve but don't center around any particular security.

I wondered if you have a comment on if you'll accept that as an assumption for a moment or perhaps want to comment on it and whether that tends to lead towards a less rather than more extreme reaction perhaps to a circuit breaker kind of an approach. And if that's correct, whether the effectiveness of that approach in turn is undermined either by what has been called the magnet effect or by a buildup of short selling interest that builds during the period when whatever follows the circuit breaker is in effect.

MR. MATHISSON: There are several academic studies that have been done on the magnet effect. Circuit breakers aren't new to the United States market. We did have Rule 80A which was the -- they call it the program trading collars and Rule 80B which halt the entire market and are still in place and halt the market in the event of a drop of approximately 10 percent. So it's not a new concept.

There have been a lot of studies around have things been drawn, like do prices get drawn to the circuit breaker price which is, you know, known as the magnet effect in the academic studies. And the overall consensus is there isn't any empirical evidence of this, and there are multiple studies that have been done on the futures market and done on foreign stock markets and they have not found evidence of prices getting drawn to this price. And part of this is sort of logical. Like as you're coming into the price, a trader is -- the last thing a trader wants to do is go in and sort of whack the bid, you know, sell the stock down to a level where something is going to trigger, that all of a sudden it's going to pull a whole lot of sellers out of the market. Traders tend to go the other way and actually start pulling back as they approach the price of the circuit breakers, and that's what many of these studies have found which were cited extensively in the comment letter that Credit Suisse wrote.

MR. BRIGAGLIANO: Commissioner Paredes.

COMMISSIONER PAREDES: Another way of getting at the balancing act here is trying not to be over-inclusive, right? You weed out the, quote, bad stuff. We can debate what's bad. And you let the good stuff in, and we can debate, I guess, at the margin of what's good.

One way of addressing that is a circuit breaker type of a concept. Another way of addressing that is by way of making sure you have the right exemptions in place. So I was wondering if you could speak to the exemptions that were offered up as part of the proposal or at least some of them. But if you -- if there's anything in particular that you think we may be missing that would be particularly important to add to the mix.

MR. SCHACK: I think it would be critical to go beyond what's laid out in the proposal now for things like arbitrage and odd lots and include -- I'm not sure how you would structure it, but include some sort of exemption that would make sure that the folks that I mentioned in my prepared comments, this high-frequency liquidity provider segment of the market is able to continue providing liquidity the way they do today. Some of these firms are registered market makers, but many of them are not so that might pose some difficulties.

If you do consider doing something like this, how do you structure it? Is it just registered market makers or is there some sort of cutoff for historical behavior, how much liquidity a firm adds to the market, for instance, on a daily basis. But I would urge you for the sake of market quality to consider something like that in the way of an exemption.

MR. MATHISSON: I would echo Justin's remarks. The ability to sell short is absolutely critical to the convertible securities and derivatives as well as the ETF marketplaces. In the rule proposal that you've put out, it does exempt registered market makers, but there is not an exemption for players that are hedge players that are not registered market makers. And we think that this is a flaw.

For clients -- for companies to be able to raise funding through the convertibles markets, there does need to be exemptions in place. We would suggest that you look at whether or not companies are net long or net short in aggregate, and if they're net long but they're putting on a short to hedge against the convertible or a derivative security, that that be considered the same as a long sale and be short exempt. We think that this would maintain smooth functioning in the convertibles and derivatives and ETF marketplaces which is critical to the functioning of the market as a whole.

MR. BRIGAGLIANO: You know, the need for exceptions ties into the power of the restrictions and, you know, I know, Dan, you pointed out the concerns about a ban with respect to liquidity. But several of the panelists have also said that the uptick rule wasn't effective at all, so I guess I'd ask you, Dan, how much of a restriction are -- would the price test proposed by the Commission be? You know, I hear you talk about the need for exceptions, but how long -- how much would short sellers be restricted by a price test at the trading increment?

MR. MATHISSON: That's a good question, and you're right. There is a bit of a Catch-22 in the argument if you're saying uptick rule is ineffective and yet exemptions are needed. And that's why the circuit breaker halt which is a fundamentally different type of restriction, it's more critical that the circuit breaker halt have exemptions than any of the others.

As for the others, we believe it would also be necessary to have exemptions at the end of the day. While the uptick rule is overall ineffective at stopping shorts from trading, at the end of the day it could stop them from sort of getting that last trade-off which could be -- which is critical for guys who are trading converts, ETFs and derivatives so that they can flatten out their book and not take overnight risk. So we would still ask for an exemption in the final half hour of the day.

MR. KETCHUM: I would certainly agree that Dan's right, that to the extent that you're dealing with the halt, you need the exceptions from the standpoint of hedge and convert in particular.

I would note two things, one from the standpoint of the gravity issue noted earlier. I think you have to be very careful with respect to gravity as to what the impact on the other side. 80A, B with respect to the New York Stock Exchange, basically, it had limited impact with respect to how many participants would be operating and be held out of the market and what they would be restricted from doing. That's very different than, say, a price limit in Japan where I'd suggest there was pretty demonstrably gravity in variety of times in the last couple decades. And until economists had looked at that, I would be careful to assume that a circuit breaker halt had no gravity impact at all.

The last point I'd just make is a plea that from the enforcement side of this that the Commission got it absolutely right with respect to your broker-dealer provision in providing the flexibility for just as in Reg. NMS for broker-dealers to manage this upstairs at the time either the quote or trade was reflected in their systems with a pattern and practice approach. That's the right approach from a regulatory standpoint to avoid technical violations. That's the right approach from the standpoint of not generating an excessive number of cancellations, and that would be the other request generally would be I would stick to pattern and practice approaches with respect to any of this. No one cares whether one or two things makes a mistake one way or another, and definitely hold on to the broker-dealer provision.

MR. BRIGAGLIANO: Thanks for addressing that key area. I think Commissioner Casey wanted to jump in.

COMMISSIONER CASEY: Thank you so much, Jamie.

I think John mentioned earlier the relationship between extreme market volatility and investors' perception of market quality and integrity and ultimately, their confidence in the markets. And I was hoping that any of you could share your experience over the past, you know, eight months on what you believe the key drivers were of the volatility that we've seen in the market, particularly short selling. And then also help me understand whether or not or how much of a role programmatic trading plays in driving volatility.

MR. CONROY: Well, Commissioner, I think that we'd all agree that this is a complicated issue and that, you know, short selling is the cough that was -- that first tips one off that they may be getting the flu. And clearly, as pointed out, I believe, in your open comments earlier that month, there were a confluence of events that took place to drive the markets to the state of frenzy.

And clearly, as Commissioner Schapiro pointed out in her opening statement, the integrity of the markets were brought into question because of recent market events. And, you know, this is the first time in 71 years that we've seen a precipitous drop in the market in three months. So clearly, it is bringing to the forefront CDS, its influence in the market, highly levered, loosely regulated, very non-transparent, heavily influencing the direction of movements of -- especially financial stocks. You know, clearly, all the issues around the housing bubble, et cetera.

So I think, you know, we can sit here and talk about short selling and bans and plus tick rules, et cetera, but I think the analogy I would draw is that if you live in a hurricane zone, you put hurricane shutters on your windows but you don't keep them closed and keep the light out for 70 years waiting for that hurricane to hit. And so, you know, therefore, because the markets have worked so well and because of the change in market structure, we advocate doing nothing. But if something must be done, putting in a circuit breaker which would help protect and ensure investor confidence during those aberrational events.

MR. KOZAK: Again, I feel like I represent Main Street. But I hear the folks on New York talk about all this additional liquidity. Am I worried about that? No, I'm not. So we have hedge funds that are doing shorts and loans and creating this additional volume. On Main Street, do I care about that? You know, it almost seems like the absence of the uptick rule, in my opinion, gives them an opportunity to make more money. And that's what I hear the other -- some of the other panelists argue for. That doesn't play well.

MR. CRONIN: I would just add that people like Brian are -- Brian and I do represent Main Street. Our institutional shareholders are retail shareholders, are in 401(k) plans, they're in mutual funds, they're saving for college, they're saving for retirement. So we do hear from these people, and our objective is quintessentially to make sure that the market structure supports their best interest.

As we look at this very complicated issue, it's not hard to for us to figure out why there's more volatility. You know, it's probably not equally too difficult for us to get to a place where we can understand where there was such limited volatility two years prior. In good times, you know, lack of volatility begets a lack of volatility. In bad times, volatility begets more volatility.

We had re-leverage or unleveraging of hedge funds which created enormous amounts of selling pressure. We had redemptions coming into mutual funds creating enormous amounts of pressure. This had nothing to do with short selling. These were long positions that we had to sell to raise the cash that people were looking to bring. So it's a vicious cycle, and it continues to sort of grow and perpetuate.

Our goal is to say look, these events happen. How do we figure out how we create a market structure which can effectively address that but at the same time doesn't compromise the time, the 90 percent, that 95 percent of the time, whatever it ends up being, the vast preponderance of time where these sort of aberrant market conditions are not in place.

So we do care about Main Street. Our thought is that the best way to protect Main Street is to continue to have a high level of transparency, efficiency, effectiveness in the capital markets. We just can't get to a place where just closing your eyes and putting a rule in fixes that. We would rather say let's take our time here. Let's have a measured approach. Let's really figure out what the problem here and address that systematically as opposed to just thinking that the politicians or whoever in the world are going to feel good about this because it's an emotional response, not a fact-based response. Let's let the facts figure out where we should go from here.

MR. BRIGAGLIANO: Chairman Schapiro had a question.

CHAIRMAN SCHAPIRO: Thanks, Jamie.

One of the virtues, I think, of the Commission having put out so many different alternatives a couple of weeks ago is that we've seen some fairly creative comment letters come in that even give us some more choices and some combination of choices of the things that the Commission proposed.

So, for example, I'd love to hear your thoughts on would a circuit -- if we were to go down a circuit breaker route, when the circuit breaker kicks in, should it kick in to a halt, should it kick in to a price test of some sort or should it kick in to a pre-borrow requirement or should it kick in to something else? And if you have any ideas on that, I'd love to hear them.

MR. MATHISSON: If a circuit breaker leads to a price test or leads to a tick test, we think on the implementation side, it's no better. Wall Street is still going to have to reprogram all the machines which is significant work. As I mentioned, we estimate it's approximately 12 months of work in that you still have to centralize all the data from all the different exchanges and put them into sequence and that's a big job. So we think a circuit breaker followed by a price test that requires sequencing is overly expensive and too difficult to implement, you know, for a very limited extra benefit.

In terms of a circuit breaker leading to a halt or leading to a pre-borrow requirement or leading to some type of a test that does not require sequencing of the quotes, it's -- you know, we think all of those would be -- could be effective.

MR. KOZAK: We're in favor of a price test. As I mentioned before, if it fell back to the circuit breaker, then obviously, we would still be in favor of a price test.

MR. CONROY: I think, as Kevin said, as someone representing 77 million accounts, many of whom are on Main Street, not Wall Street, we would again advise to do nothing. But in a case as your question asked, if there were a circuit breaker, we would advocate either the bid test or the banning and leave it really to the broker-dealer community to work with the Commission to decide which was the most effective and cost effective implementation plan for the markets. But as a buy side representative, we would be agnostic as to which solution was chosen.

MR. KETCHUM: I guess my concern with just implementing a circuit breaker is the concern I expressed earlier that I'm not at all convinced that a end of day impact with respect to short selling gets you anywhere and is particularly effective even if defined very narrowly what you want. The difficulty then if you're exactly where you -- the Commission was last fall with no alternatives in your case because the industry won't be programmed to deal with a bid test, won't be programmed to deal with anything and your only choice will be to extend the circuit breaker which I think is an absolute halt which I think is a bad idea.

If you're looking for an interim place to operate while the industry makes technical changes, I don't design the systems, but there is a place in between. And also you could consider for a longer -- somewhat longer term halt or action from a circuit breaker which is just require passive orders that don't have them hit bids. I don't know any industry firm that doesn't have a passive order capability now as opposed to worrying about whether the bid is an uptick or a downtick bid.

CHAIRMAN SCHAPIRO: When I say "halt," I don't mean halting the stock, I mean halting short selling, just to be clear.

MR. CRONIN: And I would just add to that, I think again if we were really forced into doing something, our sort of best option would be a circuit breaker based on a bid test rule.

Dan, I am sort of curious how earlier you suggest that when the halt was put in the place permanently for those group of financial stocks, how bid-ask spreads widened, how volatility increased and how volume decreased, how it would be a good thing for whatever part of the day to do a halt for the remaining part of the day. It seems to me -- and while giving market makers and others some exemption, it seems to me that if some groups get to do it, everybody should get to do it because we believe that there are valid and good reasons to do that from an investment perspective.

So we would present the circuit breaker under the context of a bid-test rule and all the exceptions that have been proposed by the Commission, we would propose to accept as well.

MR. MATHISSON: You're right, Kevin, that a halt would clearly widen bid-ask spreads and reduce volume in the main, but it would limited. What's nice about the circuit breaker is it's limited to just a handful of stocks on a handful of days. Like at the proposed 10 percent level in low volatility environment like we saw last spring, you would have about one stock a day in the S&P 500 triggering. In a very high volatility environment, you would still have something like 30 or 40. The vast majority of stocks continue to trade as normal. But clearly, when it does trigger, it absolutely damages liquidity. I don't think anyone is arguing against that.

Now, a price test that involves -- that's passive in nature and doesn't require sequencing and knowing whether or not the bid is an up or a down is relatively easy and straightforward to implement, similar to a halt.

MR. BRIGAGLIANO: Thank you, Dan.

The responses to Chairman Schapiro's question marks a great place to pause and end this panel because at 11:30 we're going to begin the next panel and get very deep into particular kinds of price tests, operational issues and we'll explore with a new set of panelists.

I'd like to thank our panelists for their thoughtful participation, and we'll do a very quick change of panels and begin promptly at 11:30. Thank you.

(A brief recess was taken.)

PANEL TWO - BID VERSUS TICK VERSUS CIRCUIT BREAKERS

MR. BRIGAGLIANO: All right. Today's second panel is entitled "Bid versus Tick versus Circuit Breakers: A Discussion of Short Sale Price Tests and Short Sale Circuit Breakers." And we'll discuss operational implications of the

Commission's recently proposed approaches to short selling regulation. Again, panelists will present brief opening statement following which the floor will be open to the Commission for questions.

And I will introduce our distinguished guests starting from my left with Jeff Brown who is the head of the Washington office of legislative and regulatory affairs for the Charles Schwab Corporation and former senior vice president and general counsel of Schwab Capital Markets. Larry Leibowitz is group executive vice president, head of U.S. markets and global technology for NYSE Euronext. John Nagel is deputy general counsel and head of global compliance of Citadel Investment Group. Jerry O'Connell is chief compliance officer for Susquehanna International Group. Bill O'Brien is the chief executive order [sic] of Direct Edge. And Brett Redfearn is global head of liquidity and algorithmic trading for JPMorgan Securities.

Jeff, do you want to start us off?

MR. BROWN: Thank you, Jamie.

Madam Chairman, Commissioners, I want to thank you on behalf of the Charles Schwab Corporation and in particular, Chuck Schwab, for holding this important roundtable. We believe this is a very important subject. Charles Schwab is -- represents about 7 million individual customer accounts. We have mutual funds. We have -- we administer 401(k) plans. So while it seems popular for a lot of people to claim they represent Wall Street -- Main Street, we're -- whatever street we're on, we do have a lot of concern about investors.

And we believe that the reintroduction of an uptick rule is necessary for the restoration of investor confidence. Retail investors have been hit hard by the market turmoil of the last 20 months. But in seeking more restrictions on short selling, these investors don't want a guarantee that their trades will win or always go up and they're not asking for a bail-out. They want a market that's fair and that they can trust and that when they put their order in, they feel like -- and the positions they hold, they feel that they will be treated fairly.

And what they will avoid is markets where that's not the case, and that's where we are today. In the absence of an uptick rule, our customers believe that the dramatic bear raids of the last year were orchestrated to transfer trillions of dollars of investor assets from customers to manipulative short sellers. As a result, our customers are staying away from equity investing and instead holding cash in extraordinary levels. And I think this is a measure of the concern they have for the marketplace. And in particular, this is, you know, troubling for the future of our capital markets and the capital raising function of our markets.

So now, when we use the term "uptick rule," we don't necessarily mean returning to former Rule 10a-1. Rather, like the Commission's proposal, we support the modified uptick rule or a bid test. We believe this rule confronts the most serious element of abusive short selling by preventing short sellers from hitting bids at successively lower levels and thereby driving prices down. Limiting short sellers' ability to create downdrafts in a security and the resulting panic that it causes among long investors goes to the heart of the purpose behind Rule 10a-1 as it was created in 1938. At the time -- at the same time, a bid test permits frictionless trading above the bid and eliminates the need to track a tick or set a tick at an increment above the minimum trading increment that we may have today.

Finally, a bid test will simplify the enforcement of short sale regulation. Two years ago, I supported the Commission's actions in eliminating uptick rules. At the time, I believed and I think I've been proven wrong that like many that our markets were so liquid that it would be very difficult to manipulate them down. And I guess the problem we faced was that we neglected the extraordinary concentrations of capital that could step in and move markets, move individual securities in a very rapid period of time. And moreover, when combined, those pools of capital were combined with unregulated products like CDS, you developed a very toxic cocktail for particular securities and that caused significant problems.

Secondly, the Commission noted in its order eliminating the uptick rules that real-time exchange surveillance systems could operate to capture manipulative activity and detect and take action in a swift manner. Well, I think that was incorrect. Detecting manipulative intent from the haystack of trading data is as hard to find as the proverbial needed. It's virtually impossible to determine intent from data. So, you know, that takes a pronounced, you know, examination by enforcement teams.

But having in place a prophylactic rule like a bid test allows trading centers to program those rules into the execution systems and thereby ensure compliance and be able to detect violations relatively easily through exception reports. We've done this with respect to Reg. NMS and to other rules, and so even in complicated systems, we can develop the electronic mechanisms to track the rules as they get put in place.

So we believe doing so goes a long way to restoring the market conditions that investors can have confidence in. So I want to thank you and I look forward to the questions.

MR. BRIGAGLIANO: Thank you, Jeff.

Larry.

MR. LEIBOWITZ: Good morning. NYSE Euronext appreciates the opportunity to appear before the Commission today. NYSE Euronext matches more volume than any other exchange complex or trading venue in the United States, and our constituents include retail and institutional investors, issuers and trading firms of all varieties.

We strongly agree with the Commission's decision to reconsider reinstatement of price tests. The global financial crisis has resulted in the loss of public confidence in our financial system. The government has taken a number of dramatic and unprecedented steps to restore that confidence, and we believe that reinstatement of a price test of some form could contribute to that goal.

While in a perfect world we'd have clear proof of the effect of these tests, the real world doesn't always lend itself to studying conditions that have not occurred before or which occur rarely. With this in mind, we understand that there's a balance to be struck between measures taken to deter so-called bear raids or panic selling and their consequences on the normal functioning of the most liquid, transparent and efficient market in the world. Indeed, a survey of NYSE issuers show that they too recognize the importance of short sellers in price discovery and providing liquidity.

Our general principle is that the stronger the medicine, the more selective we should be in applying it to the patient. And no, I didn't hear Dan's analogy before that. This means that the harsher the price test, the greater the need for exemptions and circuit breakers to prevent deterioration of market quality such as when the convertible bond market broke down during last year's short selling ban.

The simplest of price tests, the old uptick test, would be ineffective in today's market due to the improper price sequencing caused by permitted reporting delays and the potential for manipulation. The modified uptick rule as defined in the SEC proposal is much more implementable aside from sequencing issues as bids are posted in real time. Firms already use them for compliance with their Reg. NMS trade-through rule.

As a reminder, this so-called bid test was in effect in the NASDAQ place in a market structure that was substantially similar to today's, post-decimalization, electronically interconnected markets, high participation by high-frequency traders without detrimental effect. We believe that this change implemented without circuit breakers could be effective in dampening rapid or abusive short selling to underlying market quality.

Our second preferred choice would be the passive liquidity test, and it's described in a letter sent jointly by three exchanges to the SEC shortly before the release of the proposed rule changes. The passive liquidity test is a more stringent requirement than either of the proposed SEC tests requiring that short sales be done in a way that add liquidity to the market and thus should be implemented only in conjunction with a circuit breaker. The passive liquidity test also has the advantage in not requiring the sequencing of ticks or trades, thus greatly easing implementation.

Due to the complexity of either of these tests, we recommend that they be implemented in the form of policies and procedures consistent with Reg. NMS trade-through compliance. Circuit breakers in general are confusing, clumsy logistically and will increase the work required for implementation. They introduce such arbitrary considerations as at what level do we set the circuit breakers, whether different priced stocks require different circuit breaker levels, what to do if a stock retraces its losses intra-day, how to handle new situations, how long a circuit breaker should last. We discount the magnet effect previously discussed as not being critical to implementation.

Finally, we believe that in no circumstance should there be an outright ban on short selling as the damage done to market quality as seen in increased spreads and volatility is too substantial. Regardless of which approach the Commission adopts, we strongly suggest that the exemptions previously in effect during 10a-1 be reinstated in their entirely. It is essential that any rule include a market maker exemption as these participants need to make two-sided markets to enhance market quality.

We suggest that the SEC use this opportunity to better define the term market maker under the rule to account for the different types of market participants active today. We also believe it is important that the rule include exemptions for such instruments as ETFs and ETNs which have been provided no action exemption by the Commission in the past and likewise, other exemptions such as options and convertible arbitrage depending on which rule is ultimately adopted.

Thank you for the opportunity to express NYSE Euronext's views. We look forward to working with the Commission and the industry to find a balanced solution to this critical and highly emotional issue.

MR. BRIGAGLIANO: Thank you.

John Nagel.

MR. NAGEL: On behalf of Citadel Investment Group, I wanted to thank the Commission and the staff for the opportunity to participate in this important discussion.

On an average day, Citadel's funds and market making businesses account for nearly 10 percent of U.S. equity volume and nearly 30 percent of U.S. equity options volume. Given this unique vantage point, we believe that the U.S. capital markets can and should play a key role in helping lead the recovery of our economy, but this can only happen if market regulations promote fairness, transparency and capital formation and are based on facts and data carefully analyzed.

We fully support regulatory action that attacks fraudulent and manipulative behavior like Rule 10b-21, the Commission's recently adopted short selling anti-fraud rule. We urge the Commission to refrain, however, from imposing new, broad short selling restrictions without persuasive, empirical data to demonstrate that such restrictions are helpful or necessary. While you can always stop reckless driving by prohibiting everyone from driving, such a blanket approach does not achieve the right balance.

Last year, the global financial system was on the verge of insolvency and collapse, and financial markets experienced severe market declines and extraordinary volatility. Some have sought to lay the blame on short selling. These critics, however, ignore the direct relationship between last year's extreme market conditions and last year's once-in-a-lifetime collapse in economic fundamentals. Blaming short selling for 2008 market conditions is like blaming a thermometer for starting a fire.

As the Commission has recognized, short selling provides many benefits to investors and the economy, so I will not belabor the importance of short selling to liquidity and price discovery. But I will discuss a critical benefit of short selling that is not well understood by the public. Most short selling occurs to enable investors to take long positions. As we heard on this morning's panel, over 99 percent of hedge funds are net long. Short selling enables investors to take long positions because it is an efficient risk management to hedge some of the risks of making a long investment.

We urge the Commission to carefully evaluate calls for a short selling price test or circuit breaker in light of relevant empirical data. Based on the record presented thus far, we believe the outcome of the cost benefit analysis is clear. There is no basis for adopting any new short sell price test or circuit breaker at this time.

If the Commission ultimately decides to adopt additional short selling restrictions, we believe they should be narrowly tailored to eliminate collateral damage to investors and the economy. In this regard, a bid test circuit breaker could be such an approach if it includes appropriate exemptions. Thank you.

MR. BRIGAGLIANO: Thank you, John.

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 and the world's third largest stock market operator.

This debate is both timely and important, and the Commission really merits a lot of praise for taking a leadership position in fostering a constructive dialogue on these issues.

Direct Edge believes that the best approach promotes investor confidence without unduly impacting the market liquidity, efficiency and transparency that's consistently been proven to reduce investor costs over time. Narrowly tailored remedies, not broad interference, strikes the appropriate balance of ensuring market integrity without threatening market quality. Applying these principles, the current proposals to reintroduce new versions of bid or tick restrictions on the ability to facilitate short sales would appear to be a significant intervention in the mechanics of trading that does little to combat truly abusive short selling.

When effected properly, short selling facilitates the operation of an efficient, liquid market. Many brokers rely on the ability to sell short to facilitate their customer business. Proprietary traders and trading firms, many of which as we've heard a couple of times already, are fundamentally long or market neutral, use short sales in the effectuation of their trading algorithms, most of which are completely automated.

Current market structure regulation encourages the provision of liquidity from these sources by consistently encouraging the interaction of trading interests and providing minimal friction in the execution of individual transactions. This approach has been validated through consistently high trading volumes and narrow bid-ask spreads, even in volatile market conditions.

Broad restrictions on the execution of short sales without efforts to target improper conduct would have a fairly certain and significant negative effect on market operation without accompanying benefits. Studies of mature equity markets evidence that restrictions on short selling reduce trading volumes and increase transaction costs in the affected securities without preventing substantial sharp declines in asset prices. Thus the only likely outcomes of implementing these rules before the Commission is a silent tax on American investors through higher transaction costs and reduced execution flexibility with benefits that are illusory at best.

Each variant of the proposed rules have their own unique deficiencies and potential unintended consequences. Tick tests that restrict short selling based on national last sale information ignore the reality that in today's competitive market structure where executions occur in a variety of venues, trades are not reported to the tape in sequence. Thus any rule based on the tick would offer hollow comfort given the randomness of such an approach.

The effectiveness of bid tests based on national best bid information would be likewise limited given the latencies inherent in the transmission, dissemination of quote information. Circuit breakers that would trigger a rule's application only upon a security declining by a specified percentage could potentially make such declines more frequent stigmatizing issuers and driving certain liquidity out into the market even under normal conditions.

While the reform -- need for reform is real, the remedy is not in these proposals. There are concrete steps the Commission can take and in many cases has already taken to address abusive short selling practices without distorting market structure.

First, mandate regular and rigorous disclosure by hedge funds and other money managers to appropriate regulators of their short positions, including positions in derivative and exotic securities where the investor would be a direct beneficiary in the decline of the price of the issuer's common stock. In this way, enforcement officials would have a roadmap to locate perpetrators of abuse when necessary, supplementing their ability to enforce rules already on the books like 10b-21.

Second, continue the stringent enforcement of requirements regarding the location, borrow and delivery of securities sold short which have already served to significantly reduce instances of naked short sales. Supplemented by technological and other improvements in the securities lending market, this can improve inventory management and deprive bad actors of an environment that would facilitate their schemes.

By taking this approach to short sale reform, targeting abusive practices without restricting the liberty of legitimate market participants, the Commission can introduce real reform while preserving what already works.

Once again, I'd like to thank you all for the opportunity to participate and look forward to any questions you may have for me.

MR. BRIGAGLIANO: Thank you, Bill.

Jerry O'Connell.

MR. O'CONNELL: Thank you, Jamie, Mrs. Chairman, Commissioners. Susquehanna is a large options and ETF market maker, so a lot of my comments will be directed towards that activity.

The general problem with abusive short selling was largely fixed when you adopted Rule 204T. And now with few exceptions, stocks settle in a reasonable period of time.

The fails problem went away mostly with only a small loss of liquidity in the markets. That loss of liquidity was well worth it. This one for these current proposals is not. Each of the proposals would be very costly in this regard. Some, of course, more than others.

The tick rule wouldn't work operationally, and I think that that idea should be dismissed. The bid rule is a little closer to working but would create too much needless risk in stocks that are stable. The circuit breaker proposal is the best of the bunch, but I think under the theory that it'll only affect unstable stocks, we have to think about that a little bit.

The circuit breaker proposals could create problems for lots of stocks, both stable and unstable. On a down day in the market, you could have more than 100 stocks hitting the 10 percent threshold. Almost all of these stocks belong to one or more indexes, indexes that trade options, ETFs and futures. When we create difficulties in selling these stocks, we also create difficulties in trading all of these indexes at relative prices, the prices that the investment community counts on when they send their orders into those markets.

When the indexes become less efficient, so does trading in all the stocks in the index. These proposals add risk to the market which will hurt liquidity, just like when you do things to take away risk, liquidity grows. In this respect, I was glad to see market maker relief talked about for riskless principal trades, but you forgot about the options market makers. When an options market maker fills a customer and lays off the risk in the stock market, that is a real form of principal -- of riskless principal trading.

Options and ETF market makers are generally well capitalized and very efficient at managing risk. Their liquidity is needed in the marketplace. They serve in a very important role in keeping the markets linked at related prices. Some of these proposals frankly endangers that linking and in a delinked environment, that's where we see the most loss of liquidity.

If any of the proposals get adopted, we should make sure the appropriate exemptions are available for options and ETF market makers and for those other liquidity providers where needed. Thank you.

MR. BRIGAGLIANO: Thank you, Jerry.

Brett Redfearn.

MR. REDFEARN: Thank you very much to the Commission for inviting us to speak today, and on behalf of JPMorgan, I really appreciate that.

In addition to running JPMorgan's liquidity and algorithmic trading products, I also have been the chair of SIFMA's equity markets and trading committee. I'm not here so speak on behalf of SIFMA. However, I will say that in the course of Reg. NMS implementation, I spent numerous hours working with Commission staff and a lot of others to try to work out the details of the rules, so I'm very familiar with a lot of the issues with respect to implementing various types of rules.

I'd like to just say that first of all the -- you know, I think the Commission recognizes very well as do most of the panelists, I think all of them, that legal and lawful short selling is extremely important to liquidity and price discovery in the marketplace. As with the others, we commend the Commission with respect to the various actions you've taken, in particular, 204T in combating some of the abuses against naked short selling have been extremely helpful.

With respect to these proposals and proposed rules, I think that, you know, even in the proposing release, it's very well recognized what a lot of the benefits are to short selling in the market with respect to liquidity and pricing efficiency and correcting upward stock price manipulation.

The key point, I think, that I took out of this was it said it's important that any short sale price test regulation be designed to limit any potential unnecessary impact on legitimate short selling. And ultimately, I think that's what the challenge is that we have, to figure, you know, how can we sort of respond to the investor confidence concerns while at the same time make sure that we steer away from some of the potential risks and damages that we're seeing as possibilities here. And obviously, those are both to the issues of liquidity and price discovery as have been mentioned.

I'd just like to say that the world is a very different place from when these rules were in place before. We know that the velocity of trading is extremely fast, millisecond trading, microsecond trading, reports come back, bids going up from -- you know, I mean, we're literally taking in direct feeds from over 10 different market centers. We're taking in last sales from over 40 different venues. It really is a different place.

The nature of the market participants has changed quite a bit, too. People have mentioned the long-short hedge funds, the quantitative traders in the marketplace, just the activity in the way that people trade is very different. And the nature of the liquidity in the market is very different. So I think those are critical issues that we have to consider in this.

I think that JPMorgan supports the -- anything in the interest of restoring investor confidence, and if it's believed by the Commission that one of these proposals will help to do that, then we certainly want to work with you to try to figure out what the best workable solution is. I think among the proposals that have been put out there, the general belief is that a circuit breaker with a modified uptick rule proposal is really the best way to go. The issue of making sure there's a circuit breaker so you avoid putting something in place that's very cumbersome and creates frictions when you really don't have a negative market condition, that's very important. So we believe a circuit breaker's important.

In addition to that, the modified uptick rule, even though it's actually very operationally complex to put into place, we think that that as opposed to an all-out ban on short selling actually limits the frictions in the market. So we would rather spend the money and do the work to create something that limits the frictions and creates ultimately less negative impact in the market. We think that we should think about 10 percent. It may need to be a higher number for smaller priced stocks, but we can get into those details later.

Ultimately, this discussion is extremely helpful. We look forward to working with you and figuring it out and, you know, would certainly urge you to continue to look very closely at this and to apply due diligence and not to rush, so thank you very much.

MR. BRIGAGLIANO: Questions from the Commission?

COMMISSIONER CASEY: Well, thank you very much for all of your opening statements. I wanted to go back, I think, a central point that a lot of us -- without speaking for the rest of the Commission -- but raised in the meeting when we put out a lot of these proposals which was that we would be very keen on receiving any kind of empirical data or analysis that should inform our judgment, not just about the propriety or efficacy, cost to benefits for a particular proposal but also the desirability and basis for supporting taking action on any of these proposals.

So with that, I guess I would ask you all to -- if you could point to any data or analysis that you would encourage us to look at in making those judgments, what would those be?

I mean, Jeff, you spoke a little bit about what you saw as the dramatic bear raids over the past year. And, John, you had differing views in terms of, you know, what we see in terms of price pressure from short versus long selling. And so I guess I would say if we're looking for data and analysis in trying to make these judgments, which particular studies or analysis or key data points would you focus our attention on?

CHAIRMAN SCHAPIRO: If I could just add to Commissioner Casey's question and to the extent -- because one of the things we are wrestling with is this measure of investor confidence, and there are lots of terrific economic studies that we can and will look at with respect to the benefits of short selling, the implications of removal of the uptick rule at the time it was done. We're struggling with quantification as the Commission often does when it's doing rule making of the benefits to investors or the benefits to the marketplace of taking a particular action. So anything in that area, most particularly, I think would be helpful, too.

MR. O'BRIEN: Well, I would just say on the first part given the impact on micro market structure really, three sources. One would obviously the data analysis done in the wake of the ban last fall which introduced the notion, I think, pretty definitively of wider spreads and lower volumes and higher volatility in affected names. And obviously, a ban is not a circuit breaker on tick, is not a circuit breaker on bid, but I think you can extrapolate a little from that.

And moreover, I think a lot of work can be done in highlighting the impact on the individual investors. When I talk about a silent tax in my opening remarks, wider spreads are effectively a silent tax on all investors to get in or out of any individual equity. And that needs to be understood. There is a price to respond to that understandable but visceral concern over the system not being fair due to unlimited short salability.

Second, I think a lot of good work was done by the FSA analyzing similar restrictions employed in the U.K., and I think, third, some good work is being done by IOSCO in this regard globally as well. And this is an -- you know, investor confidence, that's an international problem, and it needs to be looked at. It's not just a place where only U.S.-centered data points on the confidence and overall market impact work are completely dispositive.

In terms of the impact of rules on investor confidence or not, I'm not a psychologist, and I think we could have really interesting panels on that with -- where no one on this panel is really qualified to sit on, but I would just counsel this. Leaders don't give people what they're asking for, they give people what they need and provide the strategic vision of why they're doing what they're doing backed up by very strong, effective, consistent tactical action. And I think that's the best approach over the long term to get investor confidence to where it needs to be.

MR. LEIBOWITZ: I think it's interesting to look at all the studies that are out there. There's a number of difficulties with all of them. I think what you'll find is every one on this panel -- and I know most of them personally -- are actually very quantitative and despite the fact that we come out in different positions on the issue. So that itself is kind of interesting.

First, there's a behavioralist aspect to this. So, for example, when the SEC looked at what would have happened had there been a plus tick rule in effect during this time, well, it's impossible to estimate what the feedback effects of those behavioral changes would have been. So unless the conditions are exactly the way you would have expected them to be then, it's hard to extrapolate that.

Second of all, you rarely have a control group where you have one group doing one thing and one group doing another and look at what happened between the two groups. Now, the example that is the pilot study during -- before they removed the uptick the first time, but the issues there were that we were in a very low volatility period. And what we're really looking for is very rare events, right, a panic. Right? We're not looking for things that happen every day, we're not looking for things that have happened for years, so getting quantitative analysis, it's just difficult. It's not that people are just speaking from their gut; it's just that it's very difficult to quantify these things. And I think we're all looking for that in earnest to try to find it one way or the other.

MR. NAGEL: I'd like to address both of those questions. As far as data or facts or studies supporting the critics of short sellers and supporting the notion is somehow to blame for the horrible times we all went through last year, in my view, the silence is deafening. I haven't seen it. I've heard a lot of unsupported allegations, a lot of suspicions, but I've seen very little or nothing in the way of actual facts and data to support those assertions.

On the other hand, I think there have been a lot of studies both around the pilot before the short sale price tests were removed and around last fall's ban supporting the assertions in my opening remarks about all the benefits of short selling that when removed from the market have serious consequences.

And turning to the question of investor confidence, I don't have any bright ideas as to an easy way to measure it, but I do think it's important to measure not just the impact on investor confidence of a big market break which can be very damaging to investor confidence. But when you remove short selling or hamper short selling or tax short selling and you remove the many benefits it brings to the market, markets like liquidity, like tight spreads, that erodes investor confidence because I can tell you when you have thin markets trading at wide spreads, that every day, every trade taxes investors. It costs them more money to trade, even whether it's institutional retail investors. Even retail investors are going to be asking why can't I get my trade at the quoted price? Well, the reason you can't get your trade done at the quoted price is because there's only 100 shares up, 10 cents wide.

So I do think it's important to look at not only the impact on the confidence of the break and the absence of short selling tests but also the -- all those benefits that short selling brings to the markets and what would happen as those are degraded.

MR. BROWN: We've talked in meetings about looking for data and at Schwab, we've gone back and tried to find what could we find within our company that could give you some empirical evidence. And we thought about well, let's look at this issue of investor confidence. What are our customers doing? And that seems to us to be the best way, and we've noted -- I mean, obviously, any rational investor has moved out of the market because they just saw tremendous chaos and they have decided to place a high degree of their money in cash and cash-like securities and even when -- in a time when those return minimal amounts. So they're willing to get no return on their money as long as it's safe.

And I think that's a demonstration of the concern that they have. So and then the other piece of evidence that we have about what our customers want is we get e-mails from them, and we have a tremendous number of contacts with our customers where they tell us what are you doing about the short sale rule. In fact, we have a customer who FOIA'ed the SEC to ask how many times Schwab had been in to demand that the short sale rule be reimplemented. So there are people very concerned about this, and we are trying to respond to those concerns.

COMMISSIONER CASEY: And I'd like you all to continue to answer the question, but sort of a follow-on to that as well which is if you don't have the data and analysis which supports what is viewed as the role of short selling in driving the declines that you've seen and in the markets and in financial stocks in particular. But the perception is that shorts are playing this role. And, you know, you get the response that you'd hear it on TV every day, that shorts, you know, you got bear rage. You get folks that are, you know, getting together in shorts or, you know, going to take out a particular company.

I mean, how much is that? How much concern should we have over just the fact that it's the perception that's driving this panic because that seems to be the space that we're in.

MR. NAGEL: Well, in some instance, I think perception became reality, that lo and behold there were -- you know, people would claim it was the shorts and then the -- as I had mentioned in my opening remarks, I believe the credit default swap market had a tremendous amount of coordination with short selling to create some of the conditions we saw and some of the impacts on securities.

And so I would agree that we -- there needs to be some regulation brought to that marketplace, but in any case, in some sense, our customer, retail customers do believe that this is a problem and they want to see action to resolve it.

COMMISSIONER PAREDES: Can I just jump in real quick on that point? Even if the perception is, if you will, the new reality, if it's not the real reality, is the right response regulation or is the right response some sort of investor education on the part of the Commission and on the part of all of you and anybody else out there?

MR. O'BRIEN: Right. I think it's a combination of both, and I think more education needs to be done with respect to what abusive short selling really is. And it's not short selling, per se, that needs to be broadly restricted. I think the Commission has done, as I said in my remarks, a lot already to restrict the abusive conduct.

I think there's more information and what's really changed most in the last couple of years is the promulgation of these exotic instruments that people can use in concert with short sale activity to really leverage abusive strategies and by having a greater information network and enforcement ability to pursue perpetrators of truly abusive conduct that's -- and educating the average investor about the steps that you're taking because it is a relatively intellectually lazy approach to rely on a rule that people have some familiarity with as a way to give them comfort when you know full well it's not really giving them the come back comfort and it is leaving wide very large loopholes for abusive perpetrators or conduct or continue operating in.

And over time, that might have a short boost to investor confidence, but it's going to degrade faith in the ability of the regulator to improve our markets in the long term. And that's the challenge because you can't change media perceptions overnight, but if you're consistently dedicated to that backing up articulation of a clear vision with concrete action along the way, I think we can get there.

COMMISSIONER WALTER: I guess I could follow that up by asking a question. Whether it's based on perception or the actual economic impact of the rule, I wouldn't ask of you to predict if we were to take action what the impact really would be. I mean, we can speculate about that.

There was some support on the last panel for doing something in the nature of a pilot and I think there were also some countervailing concerns about that, particularly on the cost side of the analysis because assuming that the pilot is imperfect, you could end up having to make vast system changes and then make then again. So I wonder if you could feed that into the approach and give me a little bit of a point of view on how you think we figure out what will change if we do take action and whether a pilot approach is viable or not.

MR. O'CONNELL: I think one thing we can count on, most of the empirical data on the subject over the years has one common strain, and that is that when you create risk, you kill liquidity. So we have this dilemma where there is an issue that we saw last fall and there was some selling that really couldn't be explained by any of the current studies. And I know people are out there still trying to get their finger on it.

But in the meantime, we have proposals in front of us which seem like they're going to worsen the situation not help it because if it were to occur again, what we'd need most in those instances is tighter and more liquid quotes. And I think what we do know is that when you tell somebody he can't sell something on the bid or you tell an options market maker he can't buy a call at that price because he may not be able to lay off on the stock bid, you've created risk and you've widened the quotes and they're not going to be there when you need them most if it does happen again.

MR. REDFEARN: The thing I would add on that is if we're looking at how, let's say, the modified tick test or the bid test would work in practicality in today's market, if you were to just simply look at the number of bids and ticks that we have in a given second with all the different quoting venues that are out there, you'll see hundreds literally within the course of a second in an active stock, in a volatile circumstance. In several cases, you'll see actually directional changes in the bid occurring in different directions also in the same exact second.

So one of the interesting questions here when we look at again the velocity of the market and the way the market data works is you'll see significant differences between the SIP feeds versus direct feeds that firms get. So I think we need to understand that, A, you'll have different people seeing completely different tick directions depending on which feeds that they're using; B, you'll be creating a situation where, in fact, there may very well be a down market where there's actually a momentary up bid. It might only last for three milliseconds, but there may very well be a momentary up bid in which case the shorts would potentially be able to shoot off other short positions.

So effectiveness is something that I think we really need to look at, and that goes in addition to, I think, the other comments that have been made with respect to just really let's just get behind the question of was it bear raiders or was it long sellers and try to provide the public with real information because I think there is still somewhat of a gap between what the research has shown and what the public believes. And I think that's something that we really need to get out there. We may have done a poor job of doing that so far.

MR. LEIBOWITZ: I think it's hard to find the smoking gun that says a stock has been manipulated, but just like I think we would probably all agree that most people who say oh, short sellers are the demon, just like we're hearing from a lot of other industry people, I think just as much exaggeration to the cost of such a role is going on.

I think short of an outright ban which clearly has detrimental effects, the Reg. SHO pilot study didn't show significant help to the uptick rule but it also didn't show any harm, right? So I think that one that does allow continuous trading, that isn't overly onerous, that has the right exemptions can actually not cause harm to the market and then if it does build investor confidence, then we're all to the good.

To answer the question about the pilot, I think it is potentially a good idea to have it so that we could have a controlled study. And to your concern that well, we've spent a bunch of money to discover a problem and then we have to spend it again. Well, yes, it means that we made a rule that didn't work the way we intended and now we're going to make it better. So that's exactly the right approach, and then either we'll discover well, we shouldn't do anything and we should pull it back out or we should modify it in a way that allows us to have more efficacy in the market.

I think the problem here is we don't have a controlled experiment. It's hard to imagine putting something out there, then studying it and then changing it again unless we have a good way to compare.

MR. BROWN: To address your pilot idea, I think also it's a good idea, and, in fact, you may get an indication of how issuers feel about it when they all call you to sign up for the pilot because they might want to be included in that protection, so.

MR. LEIBOWITZ: I can tell you what happened the day after the ban was announced, we got blizzarded with issuers saying I'm a financial stock.

MR. BRIGAGLIANO: Chairman Schapiro.

CHAIRMAN SCHAPIRO: I want to change tracks for just a moment. Are you all aware of short sale restrictions or tests in other countries or in other kinds of markets that we ought to be taking a look at to look and to see what the experience was that may have some parallel use for us?

MR. O'BRIEN: I think they should all be evaluated, but they need to be done in context. It can be done on a variety of issues, the efficacy of the rule generally, the impacts of certain variants of implementation of rule.

For example, with circuit breakers, we heard a lot about the magnet effect. I'm personally concerned about the potential of a magnet effect should we be in a circuit breaker driven rule application. Some studies have been proffered to say that that magnet effect doesn't exist. A lot of that's based off of the Kuala Lumpur stock exchange. And I'm a big proponent of the development of Malaysian securities markets, but don't think it's dispositive, an interesting data point but one that needs to be held in context.

So I would advocate casting a fairly broad net. We've seen a variety of rule implementations, outright bans. Australia would be an example of a very broad net cast. Others have taken more limited approaches. I think IOSCO has done a good job again, as I said, synthesizing a lot of that data. But it does need to acknowledge the fact that we have a unique and probably unique in a good way level of scale, efficiency and automation in our market that may not be replicated elsewhere and may distort the data point.

CHAIRMAN SCHAPIRO: But we also probably have a different scale of individual investor participation where the confidence issue is that much more important for us to try to address.

MR. O'BRIEN: Absolutely.

MR. REDFEARN: One thing on that point is it's safe to say that this issue being debated is not uniquely a United States phenomenon. We have a e-mail that comes out weekly with a list of I don't know how many countries, but I bet I could go with 25 to 30 different countries that's giving us updates on the various short selling provisions or rules that exist in various markets. I'd be happy to forward along the -- I can't say that we've studied the details of what's happened in all of the different cases, and many of the markets are very different than our markets. They're not as liquid and don't have a lot of the same dynamics, but certainly, there is a lot of activity out there and you've got the halts in Japan. And you could go on and on about different.

MR. O'CONNELL: I would also add to that that we -- our liquidity levels in our markets are the envy of the world. A lot of the catching up that foreign countries are doing right now is largely because of U.S. trading houses incorporating their trading strategies overseas and providing liquidity in those markets as well.

So I think it's something worth protecting, but I have heard that some of the countries that kept the restrictions on after the September problems didn't meet with much success. Those that withdrew them had sort of the same impact that they did, but I can't think of where I saw that. But I think that that was the outcome for those that left them on.

MR. BRIGAGLIANO: Commissioner Casey.

COMMISSIONER CASEY: Just a sort of follow-on to your point, Larry, which is we've heard before the fact that we understand what the costs might be with some particular proposals that have been offered up and that you can ultimately make a judgment of whether or not it actually causes harm, right? And I guess my question is: You know, what is the appropriate standard for the Commission? Is it one of saying we don't think it actually causes that much harm, therefore it's worth taking the chance that it'll improve investor confidence in the absence of something more formative? I mean, I understand. I completely get the behavioral issues here and the perception.

But I'm just trying to say as far as the rigorousness with which we engage in rulemaking, I mean I'm just trying to grapple with the fact that it makes it quite challenging if that's where the proposition that we're faced with.

MR. LEIBOWITZ: You have a tough job. I mean in all seriousness, it is very difficult because the gain is somewhat nebulous. It's Jeff's investors being willing to go back into the marketplace. Well, how do we measure that and what's the cost? Well, we're going to have to look at what's the cost in changing spreads and changing behaviors, particularly if we can do it in a controlled situation, at least we'll be able to get some numbers out of it.

I think maybe that is really in the end the best way to do this because otherwise, it's going to be very difficult to know because even when we put it in, it's going to be very different conditions than it was in the fourth quarter. If you look at the difference between the fourth quarter and the first quarter, a 10 percent circuit breaker on an average day in the fourth quarter would have triggered 400 stocks every day, right? On average in the first quarter, that was down to 225, right? And if you look historically backwards, it goes down to as low as 50 at 10 percent.

So the conditions under which we put this in are going to be very different. That's why having a pilot actually might be interesting, but this is going to be a very tough choice because it will be very difficult for you to figure out the cost/benefit. And the only sure cost will be what it costs all of us to implement it, right? So of course, all of us are going to be saying wow, this is really too expensive.

MR. O'BRIEN: Let me be a little stronger than that. The American stock market is not petri dish to be experimented with. I'm a big believer in markets as ecosystems that are a function of the participants, the economics and the rules. And when you're dealing with abusive conduct as opposed to an abusive market structure generally, you want to avoid structural remedies to conduct-based concerns. No one likes being stung by a bee, but you don't kill all the bees and then become surprised why all the flowers have all died.

We really need to look at very, very targeted remedies. The fact that oh, we don't see any -- we haven't seen any evidence before that it may not hurt, so let's try it and maybe it'll help is not the standard to be made. That does not mean the Commission cannot take controlled steps to see what impacts may be on a market structure. Pilots would be an example of that. The Commission did take a very thoughtful approach in this regard when deciding to repeal the short sale rule, but I would strongly urge not to give in to the temptation of trying things just to see what happens on a broad basis because I think your first obligation is to do no harm.

COMMISSIONER CASEY: I have -- oh, sorry, Jamie -- just one other question which was, Jeff, when you talked about the notion of a pilot and what kind of a line would be formed in terms of companies that would want to be part of that. Do you really think there'd be a tremendous amount of demand? I mean this is sort of the same question that you had around the questions associated with the ban and who would seek to be, you know, to consider themselves within the scope of the ban. I mean is it a sign of strength or weakness on the part of companies ultimately judging whether or not they'd want to be part of any kind of pilot and especially in light of what we believe might be some of the adverse consequences of having such a restriction?

MR. BROWN: I think issuers, yes, would want to be a part of the pilot. In one sense they -- if in adopting it, the Commission would determine that the rule has merit, that it will provide benefits to investors and shareholders, an issuer would say well, if it's going to benefit the shareholders, I want my shareholders benefitting. So why wouldn't I participate in the -- want to participate in the pilot? It would seem very -- you know, you have a duty to help your shareholders as much as you can and to inject them into a rule that the Commission would determine has benefit would be a very important part of that duty.

MR. LEIBOWITZ: I think it's actually a very interesting question because initially the day it was announced, our phones were flooded with everybody and their brother, even the auto companies, trying to say they were finance companies. You know GM has a finance arm or they did.

And yet as it went on, some of the firms wanted to get pulled off of it because they thought there was a stigma attached, just like some firms don't want to take TARP money because they don't want to be viewed as being in trouble. On the other hand, some firms say well, if I don't have TARP money, people are going to question whether I'm backed by somebody.

I think that that's going to happen much more with a black-and-white rule like a ban. I think if you end up with something in between like a tick test or a bid test, then I think you'll have a much more balanced approach to it, and I also think we shouldn't take suggestions because to be truly a control group, we need this to be randomly selected, distributed among industries so that half the finance groups, half are in each pot, half high cap, half low cap and really do this in a scientific -- if we're really going to do this as a control test, we need to do it that way.

MR. BRIGAGLIANO: I'd like to follow-on to a question, an area raised by Commissioner Casey. I don't want to let this group go without asking about the execution impact or bite of the Commission's proposals. The Commission proposed price tests at the trading increment.

To what extent -- and maybe we could start with John and Jerry and Brett -- would such an increment be a silent tax, a systems cost, something you have to just put up with, spend money, make capital contributions to deal with or to what extent would a price test impact executions in your view?

And if a penny increment would not have an execution impact, at what point, at what level would a price test become a ban?

John, you want to start?

MR. NAGEL: I'll take a shot at that. Let's start with at a penny increment. A price test would have a material impact on execution. It would impact some trading strategies more than others, particularly those trading strategies that need to be active and a lot of algorithmic trading strategies need to be active and maybe taken out of the market for various amounts of time depending on how frequently the test is triggered and which direction it's moving.

I do think it is something the markets could bear, and I've made clear, I think, we believe it is not helpful and is actually counterproductive. But we did have price tests for many years. The markets functioned generally quite well and were quite successful, and so we do think it's something that the markets could bear with appropriate exemptions, I should add because I don't want to lose sight of the fact that under the old NASD bid test, equity market makers had a general exemption from the bid test. Option market makers had a general exemption from the bid test.

There were exemptions for domestic arbitrage which were included in your proposal, although I would add that it's very important -- the way they had historically been interpreted required the hedges to be put on roughly contemporaneously with the position. And when you're hedging a derivative instrument like a convertible bond or an option, as the stock price moves, the stock equivalent exposure of that long position moves. And it's important to allow whoever's hedging the position to be able to adjust. Delta hedge is what people call it in the market, but basically, if the stock price goes up, your -- you'd be further out of the money and you'll need less of a hedge, and as the stock price moves down, it's the opposite direction. And you'll buy it to cover.

So we do think those are important exemptions. Also, ETFs, index products, if those are not exempt, we believe there's going to be a tremendous, completely unnecessary harm on the markets because those are really important hedging tools and there's really not a material risk of a bear raid on an index product. They've been exempt previously, and so we think that it's important that those be exempt.

As far as increments, when you go beyond a penny, you don't have to get very far. It quickly turns into a de facto ban on short selling. Many stocks trade. It's not uncommon to see a penny or two wide. As soon as you go anywhere near the actual spread or certainly over the spread, there's an actual ban because you've always got somebody in line ahead of you. And so it doesn't take very far to go.

There's no -- the right or wrong answer is depending where you're trying to set, how restrictive the test is. But just keep in mind that a penny, we've done it before. We've seen -- had some idea how it works and once you go very far beyond that, it's basically a de facto ban.

MR. BRIGAGLIANO: Jerry, would a penny increment impact your trading?

MR. O'CONNELL: It would, Jamie, because it introduces an element of risk that you'd account for in all your models. It would be something that you would have to keep an eye on every time you had an offer and you couldn't hit the bid and maybe you're not going to offer them at 12 anymore if you can't hit the 11 bid. Maybe you're going to be a 13 offer. Those decisions aren't going to be made. Maybe on every other trade or every fifth trade or tenth trade, but somewhere along the line, it's going to be made enough times that it's going to impact best execution and perhaps significantly.

And the one great thing I think of getting rid of the tick rules of the past was that old cat and mouse game people used to play with respect to if somebody was short and they didn't want to show their offer because they thought people were going to jump ahead of them and that I think that also had an effect with respect to the quality of the markets at the time. And I think we've enjoyed the period since that time. I'd hate to see it come back, but I think it would.

MR. BRIGAGLIANO: Brett.

MR. REDFEARN: I mean specifically to your question, I would generally agree with what the others have said before me, just adding that certainly, as you know, for stocks under $1.00, the quoting increment can go below a penny. So for any of those stocks, a one cent increment would too high. It would have to be in line with the quotable stocks under a dollar.

And in addition, for the rest of the stocks, if you went above a penny, that would be very harmful. And I think it would in many cases become a de facto ban. So I don't think for the rest of the universe going above a penny would be advisable at all.

MR. BRIGAGLIANO: Jeff.

MR. BROWN: Jamie, if I might, just you referred a lot this morning a lot about how whatever rule the Commission would adopt may harm liquidity. I think if you go back and look at rules the Commission's adopted or proposed over the last 25 years, there's always been a claim that we're going to harm liquidity. And yet liquidity continues to grow. We now, as Brett was saying, make hundreds of thousands of trades a second. I'm not so sure that that impact -- the market -- the trading community will learn to trade in a new environment that -- and we'll adjust.

MR. BRIGAGLIANO: Chairman Schapiro -- oh. Well, my next question would be we understand that there are systems costs, there would be systems costs in building any kind of price test capacity and the Commission explored that in its release. Do those costs differ if you're talking about a marketwide test that's on all the time versus a circuit breaker or does it cost as much to put in the system's capacity to have a circuit breaker price test as it would for a price test that's on all the time?

Larry, you want to start?

MR. LEIBOWITZ: I think it's actually incremental. You're just additive because you can think of these as independent system changes. You're going to put in the ability to do a bid test, and then you're going to add a circuit breaker on top of it. So in terms of the programming work up-front and the testing work up-front, they're purely additive.

I think going forward there's probably some incremental capacity differences based on whether I have to have enough capacity for it to be on all the time or not, but that's a different issue than the up-front work.

MR. O'BRIEN: Again, I would agree with Larry. I think it's more in the structure of the underlying rule as opposed to whether or not it's triggered by a circuit breaker or on all the time. There is some incremental work to react in response to a dynamic event in real time to trigger application of the rule, but rules that would require storage of -- and integration of data marketwide as opposed to the modified uptick rule that would be effectively be post only, that would be very easy for any one individual trading center to implement without storage of any third-party data. That drives implementation costs and time lines, I think, more than anything else, circuit breaker notwithstanding.

MR. REDFEARN: I would add to that a circuit breaker with an all-out ban, as I mentioned earlier, is certainly the cheapest way to go, but because of the frictions it caused and some of the issues of liquidity, we don't think that that's the right way to go.

If you go beyond that and then you add in the modified bid tests, there certainly are additional costs. In fact, it looks like there will be even more costs to that than there would be just dealing with all-out bid test. Again, it's interesting because we've sort of looked at it and thought that each one looks -- each proposal looks more and more desirable, gets more and more expensive.

Again, the expense is, I think, in this case not the issue, but it does speak to the question of piloting. And I would beg to differ with Larry with respect to the costs relative to what's involved here. I don't think they're overstated. I think for larger broker-dealers, if you're looking at over a dozen different trading desks with four or five different front-end systems and middle office and back office, if you go through the details, it really does add up and become expensive.

MR. LEIBOWITZ: Just to clarify, Brett, I actually wasn't talking about the costs in terms of modification of systems. I was talking about the costs of the Chicken Littles, about oh, spreads are going to widen and it's going to cost so much to trade here more than systems.

MR. REDFEARN: Oh, okay.

MR. O'BRIEN: One thing about implementation that I would also add and I think it needs to be a function of any rule is you need to give, I guess, downstream trading centers the ability to rely on compliance work done upstream. So JPMorgan sends an order to Direct Edge which is then routed to the floor of the New York Stock Exchange which would then be rerouted to another trading center for ultimate execution. If you're requiring a compliance analysis, an event, an action be taken by each of those trading centers along the way, not only does that create incremental implementation risk, it creates operational risk as well because you have orders ping ponging back and forth between trading centers. "It was good when you sent it to me. It wasn't good when it was received."

So very similar to the approach taken with Reg. NMS where the inter-market sweep order exemption was a way to give downstream comfort and reliance for trading centers executing orders. You'd need to apply a similar approach.

COMMISSIONER WALTER: While we're in this space, can you comment on the -- whether there's a cost differential of following a policies and procedures kind of approach as opposed to a prohibition?

MR. REDFEARN: I would just point out that we -- I mean assuming that I understand clearly what the prohibition means versus the policies and procedures approach. I'm assuming that the prohibition would have it such that the exchanges would, in fact, just block any short sales that were in perceived violation as opposed to a policy and procedures approach being on where as with Reg. NMS, broker-dealers, we all have different quote feeds. We would have to do our sort of best efforts with the data feeds that we would to at that point in time make a determination of whether or not it's an up bid or not.

In that particular case, I think the key point there is would it be absolutely necessary for our trading strategies and our trading algorithms and our business generally to have a policies and procedures approach because of the differential in looking at the market data quotes. It's very likely that they would actually be seeing something completely different even if it's only 10 milliseconds later than we're seeing. Hence we wouldn't be able to sort of time our trades right.

So I think that the ban approach would be -- would just wouldn't work anyway. Similarly speaking, again, the approach is more expensive for us.

MR. NAGEL: I wanted to add that I think the policies and procedures approach has one big advantage that has really proved valuable in the implementation of Regulation NMS which takes a similar approach. And that's it allows market participants to allocate among each other. There's many -- as we were discussing, there's many steps in the chain of execution of an order. And it allows market participants or market centers, market makers, brokers to figure out who's in the best position to ensure that the rule is complied with.

You could end up at roughly the same place whether you have a prohibition with appropriate exemptions or affirmative defenses for race conditions or I did the right thing and the market moved just as my order got there versus saying you have to have policies and procedures to do the right thing in the first place. But allowing the various market centers and market participants to allocate responsibility, I think is really -- makes it much more efficient when it is implemented.

MR. LEIBOWITZ: First, I wanted to thank Bill for routing his orders to the floor of the New York Stock Exchange.

MR. O'BRIEN: We're the number one router of flow to the floor of the New York Stock Exchange on many days.

MR. LEIBOWITZ: But I think what you'll find out is when first Reg. NMS was proposed, it was meant to be a hard ban on the trade-through and the more you dig into the details, the more you realize it really is impossible. And so I think that we can say anything we want, but the reality is it's almost going to have to be a policies and procedures by the time we're all said and done given how much volume is done in the TRF, given how much is done in other places, et cetera. It's the only way it's going to work.

MR. O'BRIEN: Well, the one final thing I'd add to echo Larry's comments is an outright prohibition, I think, would be an improper allocation of enforcement resources. It wouldn't be targeting truly egregious conduct. It would be -- Rick Ketchum's organization or others saying you had 17 instances, explain -- out of 10 million, explain why. As opposed to allocating to those resources and ferreting out and prosecuting truly abusive conduct.

MR. BROWN: I'd just would like to echo that I think the only way it would work is under a policies and procedures approach. The market data differences alone would cause you to -- you were absolutely -- Brett's absolutely right. You'll see different things at different times within milliseconds, and that alone allows you -- a policies and procedures approach allows you to capture the information that you see and be able to record that you've met your obligations and not have that then the short exempt -- being able to send the orders short exempt and allows it to be executed knowing that you've met your obligations. I think that's a very important part.

MR. O'CONNELL: And also with policies and procedures, you're going to have to do it if you're a large trading house because as much as it may cost, what, millions of dollars to implement, the cost of missing trades by leaving it up to latency to get to the exchange in time is going to gobble up that money in no time flat. So everyone is going to have to remodel and develop policies and procedures if they're active traders.

MR. BRIGAGLIANO: Other questions?

CHAIRMAN SCHAPIRO: Jamie, is there time for one last question?

MR. BRIGAGLIANO: Absolutely.

CHAIRMAN SCHAPIRO: In a lot of areas, the Commission works very hard to try to be coordinated with or take a similar approach to an issue as our regulatory counterparts around the world do. Is this one of those areas where it's important for us to try to achieve some kind of convergence or does it -- is it not really very important here?

MR. NAGEL: Speaking on behalf of Citadel, I would say getting the right result would outweigh convergence. If there are other jurisdictions that adopt approaches that impose substantial frictions in their market or harm the quality of their markets, I think in our view that would be a race to the bottom that I'd rather not be a part of and I'd rather take that advantage to our capital markets and to help employ people in the United States when our markets win out in the end.

On the other hand, if there is convergence around an end result that is workable, that could allow for some efficiencies in implementation. But I think those efficiencies would be very quickly drowned by the real world, everyday trading costs of a rule that is counterproductive.

MR. LEIBOWITZ: I think sharing information is really important so that -- because all the regulators must be looking at this. So what have you seen, what do you hear, what are you thinking, but this is really different than not coordinating on CDS regulation where there could be regulatory arbitrage, right? If you don't do it here, it's going to pop up in London if you ban it here.

We're not going to see short sellers arbitraging us in IBM stock by trading in London or something like that as a result of this, so I don't think you have that danger.

MR. BROWN: I would say that I think it's important that we do what's right here, and the world will watch what we do.

Also, I think you'll hear during this comment process that well, one of the problems with instituting a price test or some sort of short sale restriction is that even within our different markets, there's ways to evade it, to go around, to do some -- to establish the same type of position. And I would say to the Commission that without -- that may be true. You still have to do what's right for the market that you regulate, and if it's right to protect investors in a way you determine, then you should do it regardless of somewhere else they could trade.

MR. O'CONNELL: Larry, I hear what you're saying, but I also remember the overseas market and a lot of our U.S. listed stocks would attract a lot of volume in down days. And it was a place that people would go to, so I wouldn't be so sure that if we adopt it and they don't, that you wouldn't see some migration of our order flow overseas, some.

MR. LEIBOWITZ: You had a point there except that in general the amount of liquidity in those places is so low compared to here that the trading friction even with -- unless we do a ban. I think that the trading friction here will still be better than over there, but I understand what you're saying.

MR. O'CONNELL: Or you could be crossing over there, not necessarily hitting bids. I think that was more the pattern in the past.

MR. O'BRIEN: I think the key in whether it's in terms of the standard or the application of the rule here is to avoid opportunities for arbitrage. That could be U.S. versus offshore, that could be in the promulgation of exemptions which could give certain trading centers inherent competitive advantages over others. You need to apply an approach that's going to be able to be upheld consistently without degrading other aspects of market quality.

MR. BRIGAGLIANO: All right. I'd like to thank the panelists very much. We're on time and under budget. At 1:45 promptly, we will begin our third panel which is "Lessons and Insights from Empirical Data: Short Sale Price Tests and Short Sale Circuit Breakers by the Numbers." We have a distinguished panel of academics, and we look forward to seeing everyone back here at 1:45. Thank you.

(Whereupon, a luncheon recess was taken.)

A F T E R N O O N S E S S I O N

PANEL THREE - LESSONS AND INSIGHTS FROM EMPIRICAL DATA

MR. BRIGAGLIANO: Welcome back, everyone. Our third and final panel of the day is entitled "Lessons and Insights from Empirical Data: Short Sale Price Tests and

Short Sale Circuit Breakers by the Numbers." Our panelists will be discussing costs and benefits of short sale price tests and short sale circuit breakers from a quantitative perspective. Similar to the morning sessions, each panelist has an opportunity to present a brief opening statement and subsequently, we'll open it up to questions from Chairman Schapiro and the Commissioners.

Again, we'll begin with a very brief introduction of our distinguished panelists. Dr. James Angel is an associate professor at the McDonough School of Business at Georgetown University. Dr. Frank Hatheway is chief economist of the Nasdaq OMS (sic) Group and former professor of finance at Penn State. Dr. Charles Jones is the Robert W. Lear professor of finance and economics at the Columbia Business School of Columbia University. Dr. Robert Shapiro is the co-founder and chairman of Sonecon, LLC. He's a senior fellow at the Georgetown University School of Business and a former undersecretary of commerce for economic affairs. Dr. Ingrid Werner is the Martin and Andrew Murrer professor of finance at the Fisher School of Business of the Ohio State University.

Dr. Angel, why don't you start us off?

DR. ANGEL: Thank you. I'd like to thank the Commission for the honor of the invitation to be here. We're here because of the uproar over short selling in the financial debacle of last year, and we're here to talk about whether some form of the uptick rule should be reinstated.

I'd like to point out that the Commission got rid of the old uptick rule after a very careful study. I thought the original study was very well done. Your staff did an excellent job of designing and analyzing the study, and I think the Commission did the right thing. It did a scientifically controlled experiment. It discovered that the old uptick rule really did absolutely nothing and got rid of it.

It was a mere coincidence that the market fell apart after the repeal of the old uptick rule. However, many people, as you well know, are calling for a return of some form of an uptick rule. And some of them are responding to emotion, some of them are responding to an inherent gut feeling that there is something wrong with the price discovery mechanism in our market, that there are some reasons to be concerned about short selling.

Short selling has a lot of good legitimate uses which I defend on numerous occasions, but there are also some problems there. And yet there is this instinctive feel there is something wrong with the price discovery mechanism. With our transition to all electronic markets which trade at light speed, inter-day volatility appears to be excessive.

Last week's incident with Dendreon is a smoking gun. The stock dropped by almost half within a few minutes. Nasdaq stopped that stock as fast as humanly possible, but still tremendous damage was done. Yesterday there was a similar incident on the upside with Better Online Systems where the stock jumped for no apparent reason and then settled back down.

So I'd like to point out that these kind of moments of excessive inter-day volatility can be caused by short selling. They can be caused by a lot of other things as well. It can be caused by long selling. It could be caused by errors in trading. A lot of things can cause these kind of glitches that damage the reputation of the markets, that damage investors' confidence because when people see a stock drop by a factor of two within seconds, they start to wonder is there some kind of manipulation. There may be. There may not be.

But we need to look beyond just short selling. I think it would be a mistake for the Commission just to focus narrowly on short selling bid test uptick rule and step back and say hey, wait a minute. What people are really looking for is a shock absorber. What people really are saying is hey, there's something wrong with our price formation mechanism. It's misfiring and whether it misfires once out of 1,000 times or once out of 10,000, it only takes a few of these events to damage the reputation of the markets.

And so what people are saying is hey, we need a shock absorber. And whether it's the old uptick rule, a modified uptick, a big (sic) test, I think we need to look beyond mere short selling. If we look at other computerized exchanges around the world, almost all of them have some kind of circuit breaker, price halt, special quote system, special restart mechanism to deal with these situations.

So this is what I would urge the Commission to do is to think beyond the narrow technical box of short selling and move into the broader and say hey, what, if anything, should we do to deal with this excessive intra-day volatility?

And finally, even though I think the Commission did the right job getting rid of the old and useless uptick rule, I think the Commission made a serious mistake in dropping the transparency we had with respect to tick by tick short sales. One of the great things about the pilot is that we had tick by tick data telling us which trades were short. We don't have that anymore. So whenever anything bad happens in the market, there's a natural tendency to blame the short sellers. People have been doing that for 400 years, will probably do it for the next 400 years. But if we have better transparency about the amount of short interest, better transparency about which trades are short, better transparency about settlement failures, then people can see for themselves whether or not there's a problem.

So once again, I want to thank you for the invitation to be here, and I'll turn it over to Dr. Hatheway.

DR. HATHEWAY: Thank you, Jim. Good afternoon, Madam Chairman and Commissioners. I want to thank you for the opportunity to participate in this panel.

I also want to applaud the Commission for its actions to reduce naked short selling. Through these efforts, the Commission reduced the number of listed companies on the threshold securities list by over 98 percent in the eight months following adoption of Interim Final Rule 204T.

Throughout my 25-year career in finance as an options trader on the Philadelphia Stock Exchange, as a professor of finance at Pennsylvania State University and as Nasdaq's chief economist, I have closely observed the evolution of short selling on domestic and global capital markets and the inter-related asset classes that trade the equivalent short positions at an ever increasing pace.

Regulating short selling is about balancing liquidity, transparency, price discovery to best benefit all market participants. Investors, member firms, listed companies agree that short selling provides valuable liquidity and price discovery that contributes to the world-class efficiency of our capital markets. Participants also agree that abusive short selling harms investors and companies listed on our exchanges and also erodes confidence in the U.S. markets.

And by abusive short selling, I mean attempts by speculators to artificially push down stock prices through selling short. Although the SEC has anti-manipulation tools at its disposal, including newly adopted Rule 10b-21, many market participants believe that real-time restrictions are required. In setting the restrictions, regulators are aware that a link exists between domestic and global markets and also between the asset classes.

Short selling in equities and options are closely linked, and there are additional links to index products, futures and other derivatives. As a result, regulation of one asset class impacts linked asset classes and domestic regulation can impact global trading patterns.

Recognizing the need to balance liquidity, transparency and price discovery and the link between asset classes and global markets, Nasdaq's view is that the Commission should adopt two measures. First, the circuit breaker that the Commission described in its proposing release that would be triggered when an individual stock experiences a decline of 10 percent or more from the previous day's closing price. Second, when the circuit breaker is triggered, short sales would be subject for the remainder of the trading day to the exchanges' modified bid tests that we described to the Commission in a joint letter dated March 24th, 2009. These measures are in Nasdaq's view not separable.

As discussed in the morning panels, circuit breakers are preferable to price tests because price tests are significantly over-inclusive in application. By contrast, circuit breakers impose such costs only when a potential problem may exist which could be in over 10 percent of the S&P 500 on a stress day. While these costs will prove unwarranted in some percentage of circuit breaker events, the circuit breaker eliminates unnecessary compliance costs in the up to 99 percent of trading where trades can proceed safely without order by order short sale restrictions.

After a circuit breaker is triggered, the follow-on restrictions imposed by the exchanges' modified bid tests will be superior to the traditional tick test and the modified tick test that the Commission proposed. Under our modified bid test, short selling can only occur on a passive basis at a price materially above one tick, the highest prevailing national bid. This type of passive test was mentioned earlier by Dan Mathisson and Rick Ketchum.

As such, short sales would only execute at a higher price than the prevailing market. In today's automated markets in which a bear raid can be completed within 60 seconds as Jim just described, modified bid tests would be more restrictive than either the traditional or modified tick tests due to the vast increase in the number and speed of quotation changes. You now don't have to follow the sequencing under the exchanges' proposal.

Consequently, the Commission's traditional tick tests would be less effective now than their antecedents were in 2007. It's important to note that the original tick test of the NYSE was derived for an auction market. Nasdaq bid test was derived for a dealer market. We now operate order driven markets with electronic books. Whatever price test should be implemented needs to take into account the fact that the markets work different in a very fundamental way than they did in the 1930s or in 1994.

Again, thank you for this opportunity to present Nasdaq's position on short sale proposals currently under discussion. I anticipate the opportunity to expand on this summary and provide additional empirical evidence to assist the Commission in adopting measures that strike the right balance for today's marketplace.

MR. BRIGAGLIANO: Dr. Jones.

DR. JONES: I'd like to thank the Commission and the staff for conducting this important information gathering effort and thank you for the opportunity to appear before you today.

Over the years, many people have studied the data on short selling, and the empirical evidence is remarkably uniform. Research has shown time after time after time that short sellers ferret out overvalued companies and help keep stock prices from getting too high. For example, short sellers were the ones who uncovered the Enron fraud. However, when stock prices go down, short sellers are always blamed. It happened in the Great Depression here. It happens the world over every time stock prices fall sharply.

In the current financial crisis, short sellers have been blamed for bringing our financial system to the precipice. But never mind that the fundamentals at firms like Citigroup, Merrill Lynch, Lehman Brothers were absolutely horrible. Short sellers should have received accolades for seeing this ahead of other people. Instead, we're demonizing them.

There will always be bad apples, and short sellers are no exception. Based on the record, it appears that manipulative or abusive short sales are quite rare, and I think they can be deterred by aggressive enforcement action.

The data clearly say that short sellers in aggregate perform a valuable watchdog function. If you want to further restrict short sellers, I think you need to argue that those data are somehow now relevant, that something is different now than what it was before when all these data were collected. From my vantage point, I don't see anything in this particular downturn that renders all that previous data moot.

Now, I understand you may have access to some additional nonpublic information on recent actions of traders and investors, and by all means, you should incorporate that knowledge into your decision making. But if you do impose new restrictions on short sellers, I hope you will explain what is different this time around and why it is that we should discard all the evidence to date on the valuable role of shorting in making stock prices as informative as possible.

Now, let me talk a little bit about some of the empirical evidence that we have in place on the likely effects of some of the proposed rules. Along with Ekkehart Boehmer and Xiaoyan Zhang, I've studied the 2007 repeal of the uptick rule. It turns out stock price levels and market quality were essentially unaffected by the repeal of the uptick rule. There does not seem to be a change in short interest, either, associated with the uptick rule.

This implies that actually reinstating short sale price tests -- and I expect that a bid test would have similar effects to the old uptick test so that those results from 2007 could be extrapolated. I don't think they'll be much effect on stock price levels or liquidity of the stock market, and it seems like it would have little effect based on the short interest data on short sellers' ability to amass a short position over the longer term.

However, it's important to remember that price tests will impeded shorting considerably. In July and August 2007 just after the repeal of the uptick rule, shorting was about 40 percent of trading volume, and based on the evidence around the repeal, about 7 to 15 depending on how you count of those percentage points would have disappeared if we had gone back to having price tests. So that's about one-fifth of the shorting activity that would disappear if we had the -- if we reinstated these price test rules.

Now, since short interest doesn't change much, this suggests that the short sale price tests are mainly impacting short sellers with a shorter horizon. Now, we talked a little bit about some of these high-frequency algorithmic traders and liquidity suppliers this morning, and certainly, they're in that category. And so this would certainly affect some of their trades, but also an investor, for instance, who believes that IBM's earnings are going to be short tomorrow, that they're going to fall short of expectations may have difficult achieving her desired short position in the presence of an uptick rule or another price test. These effects will actually -- these will affect real traders with real fundamental views on the prospects for a stock.

In a second paper, the same co-authors and I have studied the effects of the temporary shorting ban in the fall of 2008. The main thing we find, of course -- and this has been alluded to several times in today's panels -- is that market quality was severely degraded in the stocks that were subject to the ban. Spreads were much, much wider. Volatility was much, much worse. Price impacts and other measures of market quality, severely degraded.

So we believe that the shorting ban sharply restricted the activities and informal market markers, and so the proprietary trading desks and hedge funds that do this informal market making were simply unable to provide liquidity. And so market quality was simply horrible as a result.

So based on what we saw during the shorting ban -- and again, this was mentioned by a couple of panelists this morning -- I would strongly counsel against any sort of circuit breakers that includes an outright ban on shorting. We are likely to get poorly functioning markets exactly at the time when it's important that markets work well. In sum, I think the Commission should be aware that new restrictions on short sellers are likely to reduce the amount of information incorporated into stock prices. Thus the less often the new restrictions come into play, the better in my view. And in terms of the type of restrictions being considered, price tests are vastly superior to any sort of ban on shorting activity.

Thank you very much.

MR. BRIGAGLIANO: Dr. Shapiro.

DR. SHAPIRO: Thank you very much for this opportunity to be here and address these important issues.

I'm going to step back and discuss the economic context for some of these issues with regard to one aspect of short sales that has raised calls for more regulation, and that's fails to deliver. Since 1989, investors, scholars, market analysts have urged the SEC to address the problem of fails to deliver of shares sold short which principally consist of naked short sales, and since 2004, the SEC has taken a number of steps to discourage new fails and encourage or require investors and broker-dealers to resolve their outstanding fails, principally through Reg. SHO and its amendments.

And these efforts have reduced fails during certain periods, but the number of fails also have periodically risen to record levels. There's also evidence that very large-scale naked short sales and the fails they produced played a role in the sudden and unmanaged collapse of Bear Stearns and Lehman Brothers, not that they caused the collapse but that they affected the manner in which those companies collapsed.

Despite the measures taken by the SEC, fails continue to persist at levels greater than those which occurred before Reg. SHO. These findings come from a new study I've completed on short sales and fails. Let me review a few of the findings. Current regulation has not stemmed fails in a meaningful, consistent and permanent way. In the first three months of 2008 before the collapse of Bear Stearns, fails on any given day affected almost 4,000 companies, averaged more than 1.1 billion shares cumulatively, more than twice the average level of both the previous year and the first 15 months of Reg. SHO. Those fails also were highly concentrated sufficiently to affect the share prices of many stocks under certain conditions. One hundred companies or less than 3 percent of those with fails of more than 10,000 shares accounted for 70 percent of total fails.

By March 2008, the 100 stocks with the largest outstanding fails averaged 9.3 million fails each. As the financial and economic crisis unfolded fails increased sharply, reaching more than 2 billion shares in July 2008 with an estimated value of $30 billion based on share prices one month before fail soared and helped depress prices. These fails were linked to sharp increases in short sales, including those affecting Bear Stearns and Lehman.

From the first quarter 2007 to March 2008, short sales of Bear Stearns increased fourfold to 23 million shares while fails to deliver those shares increased 145-fold to 14 million shares or 59 percent of the stock's short interest. Despite the emergency measures by the Commission to stem naked short sells, the same dynamics unfolded at Lehman Brothers. From third quarter 2007 to September 2008, short sales of Lehman increased fourfold to more than 100 million shares, and failures to deliver those shares increased 151-fold to 50 million shares or 46 percent of the stock short interest.

Fails fell in the fourth quarter compared to the historic highs of the crisis. SEC regulations certainly played a role here, especially in ending the option makers' exception to Reg. SHO which reduced fails in optionable securities, threshold securities by over 77 percent.

But naked shorts and their attendant fails still remained at troubling levels. Average monthly fails of more than 525 million shares during the fourth quarter were greater than the average quarterly fails in the first year after Reg. SHO was implemented and comparable to levels in mid 2006.

While we expect a decline in short interest in fails following a sharp decline in equity prices regardless of regulation, measures other than average monthly levels of fails on a quarterly basis show fails remaining at even higher levels in 2008. Using -- in late 2008.

Using SEC data to track maximum fails in December 2008 for all companies with at least 10,000 fails, we found that despite the new close-out rules and the end of the option makers' exception, these maximum measure of fails in December 2008 reached 885 million shares and maximum monthly fails over the whole fourth quarter averaged nearly 1 billion shares.

Moreover, fails have remained highly concentrated even as their total numbers decline. The number of companies with at least 10,000 fails which reached 3400 in four firms in July 2008 fell to 1275 companies by December 2008. However, the top 3 percent of those companies in July accounted for about 74 percent of nearly 1.6 million outstanding fails, an average of 11.6 million fails each for the top 3 percent. In December, the top 3 percent of companies with at least 10,000 outstanding fails accounted for 79 percent of 501 million total fails or an average of 9.9 million fails each.

We also established that these fails are not particularly concentrated in any sector. They occur across the economy. They are not particularly concentrated on any exchange. They are in the New York Stock Exchange, the Nasdaq and the over-the-counter. They are not particularly concentrated in small, very small companies, in micro cap companies. They occur in large cap, medium cap, small cap and micro cap companies. Nor are they concentrated in companies with greater than average insider ownership. They are again distributed as you would expect.

Finally -- and we created a database of all 5,500 companies that the SEC reported had fails of at lease 10,000 shares from January 2007 to December 2008, and then we ran a series of regression analyses. The regression analyses on these data did establish a close relationship between short sales and fails, again across sectors, exchanges, market caps and insider ownership. However, the analysis did not find a close, or significant relationship between short sales and trading volume in these companies, suggesting that short sales are not a critical factor for these stocks' liquidity and that other factors drive the liquidity of individual stocks in the overall market.

This relationship was strong and significant only for companies in one sector, the consumer goods sector. There were no significant connections between short sales and trading volume in the other seven economic sectors for stocks listed on the NYSE or traded over the counter for small and medium cap companies.

Finally, we tested the incidence and significance of short sale abuse. To do that, we used fails as a share of short interest, as a proxy for short sale abuse. We found that overall financial sector companies were generally -- and this is over 2007 and 2008 -- less vulnerable to short sale abuse than companies in other sectors, that this phenomenon is not generally concentrated in finance.

Again, using fails as a share of short interest, as a proxy, we found that fails represented 2 percent to 4 percent of short interest among financial companies compared to between 4 percent and 11 percent for companies in the other seven non-economic, non-financial sectors.

MR. BRIGAGLIANO: Dr. Shapiro, I think we should move along to Dr. Werner. Thank you.

DR. SHAPIRO: Okay. Sorry.

DR. WERNER: I guess I need to press the button. First, I would like to thank Chairman Schapiro and the Commission for inviting me to participate at this roundtable. I think it's an important event and an opportunity to clearly evaluate the Commission's recent proposed amendments to Reg. SHO.

I last participated in an SEC roundtable in September of 2006 as we discussed the empirical evidence from the Reg. SHO pilot. The empirical evidence presented by academic researchers as well as by Commission economists at the time showed that temporary suspension of price tests was associated with a slight increase in short sales but did not cause stock prices to fall or volatility to increase. Importantly, there was no evidence of an increase in downside volatility or other return patterns associated with bear raids and reversals. Further, the effects on inter-day market quality measures were limited and mostly associated with asymmetries in order flow created by the specific form of the price test in force.

So after evaluating the empirical evidence and considering the public comments as well as the feedback from industry participants, the Commission voted unanimously to permanently suspend the uptick rule and the bid tests in July of 2007. The SEC also prohibited the use of any short sale price tests by SROs in the future.

And now in an interesting turn of events, we are back here again, and this discussion is seeking public comment on introducing either a price test that would apply on a marketwide basis and permanently or one that would apply only to particular security during severe market declines in that security.

I must say that is unclear to me what the SEC hopes to achieve by these proposed amendments. As I already mentioned, in 2006 we all agreed that price tests did not significantly affect short sellers' ability to execute their short sales, had no effect on prices and volatility and did not cause a decrease in return patterns consistent with bear raids and had very limited effects on market quality.

More recently, the Commission staff economists and other academics have studied short sales in declining markets and confirmed that price tests do not impair short sellers' ability to execute their orders even in rapid declining markets. Moreover, as I read it, the experimental and existing empirical evidence suggests that circuit breaker, particularly if a company is by a short sale ban, may cause an increase in short-term volatility due to the so-called magnet effect.

Even though price tests aren't likely to have a significant effect on markets, in my mind, I am opposed to reintroducing constraints on short sales. I echo Dr. Jones' comments. Academic research shows that short sellers are important contributors to liquidity and market efficiency. In fact, I can think of no academic study that has found short sellers to have a negative effect on markets.

Nevertheless, investors, issuers, media representatives and politicians argue that short sellers are responsible for the recent precipitous decline in financial stocks and other stocks. Yet I have found no empirical evidence showing that short sale caused the price declines of financial stocks. Incidentally, I have not found any evidence that short sellers were engaging in fraudulent market manipulation during the recent financial market crisis, either, but obviously, I do not have access to such data.

Since prices tests and circuit breakers are likely to be relatively innocuous, what's the problem with adopting the proposed amendments you may ask? The problem, as I see it, is that the SEC cannot afford to get sidetracked. Instead, I believe that the SEC should focus its scarce resources on enforcing its existing rules against delivery failures and market manipulation and on continuing its important work towards greater market transparency.

I applaud the Commission's regulatory action to eliminate delivery failures by adopting tighter rules on locates and closeouts both in Reg. SHO and subsequent Regulation 204T and also the elimination of the option market maker exemption from the Reg. SHO closeout rules. As shown by the Commission's own staff and academic studies, these regulatory initiatives have dramatically reduced the number of stocks with significant failures to deliver.

I'm also pleased to see that the Commission intends to get serious about prosecuting cases against market manipulation through the adoption of the anti-fraud exchange Rule 10b-21. I believe that together with the existing securities law, this should provide ample ammunition to go after market manipulation.

Finally, I would urge the Commission to push for more transparency in all aspects of short sales. While stock level data on shorting activity is regularly gathered and reported, investor level data on short positions have until recently not been collected. Such data would permit the Commission to regularly monitor short sellers to more easily detect possible manipulative short selling activity. The Commission's move to expand the reporting obligations of 13(F) institutions to include reporting of short positions on Form SH is an important step in the right direction.

I would also encourage the Commission to require more pre-trade as well as post-trade transparency in the stock-lending market. I believe that this would go a long way towards demystifying the mechanics of short sale transactions. I would also facilitate -- excuse me. It would also facilitate the determination of a fair-market price for stock loans that is based on market rights of lendable shares. Finally, it may encourage brokers, custodians and other stock lenders to pass through a greater proportion of the stock-lending fees to long investors.

In closing, I urge the Commission under its new Chairman Schapiro to refrain from adopting short sale price tests and circuit breakers and instead focus on adopting regulation that enhances market efficiency, liquidity and transparency. Thank you.

MR. BRIGAGLIANO: Well, thank you, Dr. Werner and thank all the panelists for their thoughtful statements.

Questions from the Commission? Chairman Schapiro.

CHAIRMAN SCHAPIRO: Thanks, Jamie.

Let me thank you all very much for being here. It's enormously helpful to us to hear your views, and you will absolutely be informing our process as we go forward. I would just say in response to Dr. Werner that what has changed is that we have just gone through the worst economic crisis since the Great Depression. And while that doesn't dictate a particular outcome, I think it does dictate that we consider whether changes in market structure and in how the markets are operating could be appropriate in the interests of helping to restore investor confidence.

And that's really where my question goes. Those of you who were here this morning heard our struggle with trying to assemble some data or some studies or information about investor confidence and what has been the impact of the removal of the uptick rule on investor confidence or what impact reinstatement of some kind of governors whether it's an uptick rule, a bid test, other methodologies, disclosure or other processes could help to restore confidence of investors who might be then willing to come back into the marketplace.

And is there data, are there studies that you're aware of, are there things that we could be directing our economists to look at that might help us get at that ephemeral investor confidence question that we're so deeply trying to understand here?

DR. JONES: I'll take stab at it if nobody else wants to.

I think that data is very hard to come by, of course, and I don't know of any studies that are out there. I thought we did have somebody from Charles Schwab this morning, and I think some information about his customer base and how many of them have withdrawn, for instance, completely from the stock market, that might be sort of instructive in telling us what fraction of the populace might have lost confidence in the markets.

We could get -- it's possible perhaps to find a Vanguard or some other large asset manager who collects a lot of retirement accounts and things like that and ask them certain questions about what fraction of their people have gone to all cash. I think that's the kind of thing that is knowable, although it's proprietary data. So I think that academics are unlikely to ever have access to it.

CHAIRMAN SCHAPIRO: Of course, it doesn't give us the absolute connection to the short sale restrictions. People could have pulled out of the market for a variety of different reasons, so I guess we'll keep searching.

DR. ANGEL: I don't know of any particular studies with good data on investor confidence, but there are numerous studies on consumer confidence that are based on survey data. So the Commission may want to consider starting a regular data collection process that would actually measure investor confidence. It would require quite a bit of resources, quite a bit of planning, but it could be extremely useful going forward for collecting the data because as you rightly realize, investor confidence is extremely important and yet we don't exactly know but we can feel that there was a big loss of investor confidence.

COMMISSIONER WALTER: Professor Angel, do those studies also follow what factors create either increases or decreases in consumer confidence? Because it seems to me that the question we're really focused on here -- I think we can probably all pretty much agree there's been an incredible decrease in investor confidence. But what we want to figure out is what levers will increase investor confidence, and since there are so many variables, I wondered whether we'd be able to track even long-term. Do you have a point of view on that?

DR. ANGEL: I don't have a view on the consumer confidence studies. I know the data are collected, but exactly what variables have been found to drive consumer confidence, I'd have to pass on that one.

MR. BRIGAGLIANO: Commissioner Paredes?

DR. SHAPIRO: While I don't know of any American studies, there may very well be -- there certainly are studies going on right now in a number of countries of the impact of new rules which have been placed on short sale transactions throughout this crisis. And I know the Australian stock exchange has been studying the impact of their new rules. There have been a number of studies done by the Hong Kong exchange of the impact of their rules. We have new regulation of short sales in about six or seven European countries.

So there are -- while we may not be able to get directly at consumer confidence, we can probably get at the result of that confidence; that is, in actual transactions. So I'd recommend a review of those and conversations with your fellow regulators in Australia and Europe.

DR. HATHEWAY: If I may, another dimension of confidence we can look at is our own history. 1987, we had short sale constraints, we had a market crash. That was the previous once-in-a-lifetime experience I've been through. And again in the 1970s, we had a substantial bear market in the presence of short sale constraints with a loss of consumer confidence or investor confidence in both cases. Whether it's a difference of degree or not, it would be very hard to tell.

I'd like to differentiate between macro consumer confidence or investor confidence which is what we're talking about for the last couple minutes and a micro level which is one of the things that Mike McAlevey talked to the morning panel and Jim Angel brought it up a moment ago. And that's short-term trading events that can damage investor perceptions about the market as a fair game.

And again, it's hard to measure the confidence impact of a stock like Dendreon having the trading event that happened to it or Better Online Systems. But that's an area we can focus on. My team does look at these trading events and refer to see information we find over to FINRA and to the SEC as appropriate. And at that level of detail -- and not to speak to any particular event and any particular stock because of the potential enforcement actions that may be involved -- you do see behaviors that one would ex ante expect to be part of a bear raid strategy in terms of the mix of short selling and long selling, what occurs when, these very short time horizons.

COMMISSIONER PAREDES: On the question of how much has changed or the extent to which we've just gone through is unique in terms of the amount of stresses and strains and all the rest, the financial system and the economy, it certainly calls for reconsideration of questions along these lines, but it doesn't necessarily mean that the prior economic studies don't continue to obtain by way of their results.

And so the question I have is, is not withstanding that we can identify this as a unique period, are there reasons that we think the prior studies and their results were not obtained or have obtained during a period like that; that is to say that in a period like this an uptick has more bite than it might in other periods or that it has different consequences in terms of adverse consequences for market quality?

DR. ANGEL: The pilot study occurred on during a period that Federal Reserve Chairman Ben Bernanke referred to it once as the great moderation, when volatility in the equity market fell to abnormally low levels. So one might say oh, it was an abnormally quiet time, so it doesn't apply. I disagree because even though it was during the great moderation, there were numerous times during that sample period when individual stocks experienced periods of great volatility and we got the results we did.

So I still believe that those results are basically valid in that the old uptick rule really did not provide any benefit to the market. So I think it's pretty clear that going back to the old rule would be a big mistake, but I still think that we need to think about what kind of shock absorber we need now that we have transitioned to all electronic markets.

DR. HATHEWAY: I think one of the weaknesses in the studies that were done during the pilot -- and this is no reflection on the people who did them. This is a weakness that was acknowledged in most of those studies -- is the bid test rule was not a SEC rule. It was not a national rule. It was an NASD rule, and there was some uncertainty in at least in the minds of certain market participants whether the bid test constraints on shorting and Nasdaq listed stock applied to trading on ARCA or on INET.

So there was ample reason to believe ex ante that particular bid test may not have been effective, and so studies of the bid test during the pilot period don't necessarily reflect how a bid test could constrain short selling or what its costs or benefits might be at a national level.

DR. WERNER: If I may chime in, I have looked at some of the studies that have more recent data to try to evaluate whether an uptick rule would work as a brake against market decline in severe stress. And my reading, although these are not my own studies, is that the evidence suggests that it's not effective. In fact, I believe that some of the Commission's own economists have found that the uptick rule was less effective when needed most during panics that drive prices down and volatility up. And even with the delays that may be involved in the execution strategy; that is, waiting for an uptick, there's enough volatility to execute the short sales if the short seller so desires.

And this type of evidence has been found by academics independent of the Commission as well in looking at negative earnings announcements and looking at the participation of short sellers in control versus pilot stock. That's back to the Reg. SHO, the period during the pilot, but also found that the uptick rule did not work as an effective brake.

DR. HATHEWAY: If I could respond to that for a second -- go ahead. I'm sorry. I already had my shot.

DR. SHAPIRO: No. It's okay. But this may not be very helpful, but the truth is we don't know. We think that -- we assume that the markets will behave essentially after this crisis the way they did before. We don't know that. This is a very large discontinuity. We'll have to see.

I think that the prudent course at this time is to identify those factors which played some material role in the unfolding of this financial crisis and address those and then observe how those changes in the regulatory topography affect the behavior of markets which arise out of this crisis. I think it is a mistake to assume either that markets will behave just as they did before or that markets will behave significantly differently. We're going to have to see.

DR. HATHEWAY: If I may, the point I wanted to make in response to Ingrid is I wanted to draw a distinction between the ability to execute a short sale which we think there's nothing wrong and the ability to artificially push down prices which we think there is something wrong with it. And one of the distinctions between the exchanges' modified bid test and the one in the proposing release is the ability in the proposing release bid test to hit bids when it's an up bid. In the exchanges' proposal, you cannot hit the bid, so you have to be on the passive side of the trade.

In addition to making compliance potentially easier because you don't have to follow the sequencing as was discussed this morning, you do force short selling into a more passive role if the goal is price manipulation, not so much the execution of a short sale.

One other point on that, the Commission staff can see who's aggressive and passive. I can see it. My colleagues on this panel cannot. So as you talk about requesting empirical results and research making available to the academic community the information on aggressive and passive selling at the level known by the exchanges and the Commission has some advantages as opposed to using something called a Lee and Ready algorithm which is basically a scientific guess.

DR. WERNER: Thank you, Frank.

CHAIRMAN SCHAPIRO: Your request is noted.

Let me ask a question. We talked about this a little bit this morning but -- and I said one of the benefits of the Commission putting out so many different ideas was that people have almost taken it as a menu of things and combined different components of the Commission's several proposals.

And one of the things that's been interesting to me is to see the idea that the circuit breaker latched onto by a number of people but with the circuit breaker triggering different potential outcomes. One would be a halt on short selling for a period of time, maybe till the end of the trading day, maybe for several days thereafter. The other would be that it triggers a price test or some other -- either a tick test or a bid test. And the other is that it might trigger a hard borrow requirement in that stock for some period of time.

And I wondered if you all had any thoughts on the relative merits or demerits of any of those approaches, assuming -- understanding that some of you don't like the idea of anything at all in this case.

DR. HATHEWAY: May I? One of the things that struck me about this morning in discussion about the circuit breaker, particularly for those commentators that didn't want one, so this is a chance for my colleagues to think about what I'm going to say after I've said it rather than before.

If you don't have it, what else in terms of how the trading community is going to behave? We have seen an emergency order with very, very little notice. So if there is no constraint on short selling in place and we have a market break, what goes through the minds of market participants as they plan their trading strategies? Is it not perhaps the same thing or maybe even more severe than the losses of liquidity we heard about this morning in the event of a circuit breaker going off?

So I think that the analysis this morning was missing that part of the game theoretic analysis -- yes, I was at Eric's going-away last night -- that needs to be done when you think about this process.

CHAIRMAN SCHAPIRO: Just so I understand, are you talking about just predictability, people knowing what the rules are --

DR. HATHEWAY: Exactly.

CHAIRMAN SCHAPIRO: -- before the event hits and then everybody's scrambling instead of understanding at this level, this will happen?

DR. HATHEWAY: Right. And Rick spoke to also this morning the need for the Commission to have some flexibility within this approach. One nice thing about a circuit breaker, 10 isn't magic. If you get on -- the rule is written in such a way that 10 can be changed during times of stress in terms of circuit breaker level. We code to it. We know it. It's a possibility, and we can take that into account. Hard rules, you don't necessarily have that flexibility to that.

DR. JONES: I want to reiterate that I think a complete ban on shorting after a certain level of decline is sort of the worst thing we can do to a stock that is down. I think that stock really needs liquidity at that point. It needs maximal participation, and if you put these rules in -- if you put a total shorting ban in effect on a stock that declines by a certain amount, you're going to have withdrawal of participation in that stock. And so I think it's going to have exactly the reverse effect than what you hope to have happen there.

I guess I think most people here are pretty comfortable -- maybe I won't speak for everybody, but it seems like the pre-borrow and locate requirements that are in place right now are working well. I'm not sure I see a need for making those contingent on a certain amount of a decline or not. It seems to me like we could impose some of those requirements all the time, and that would work just fine which I think leaves us with your last proposal which is some sort of price test in the event of a certain amount of a decline would I think be the least damaging of any restriction that you could put into place.

COMMISSIONER WALTER: There was conversation earlier today about a variety of proposals, but one thing that we have not yet talked about which I have heard some people discuss is the notion of at least in less liquid stocks actually mandating that they only be available to be borrowed once. Do you believe that that has any merit in terms of tightening up the system? I throw that open to anybody.

DR. ANGEL: I think it would be very hard to monitor and implement that in that if somebody owns a stock -- I buy a stock, part of my ownership right is I can lend it out. Now, the fact that I happened to have bought that stock from a short seller, I don't know that. Our markets are anonymous. So how can you tell me that I bought a stock and I can't lend it out when I don't even know who I bought it from? Especially given the netting that occurs in the CNS settlement system, I don't see how a system like that could be easily monitored and enforced.

What you could do, though, is you could have a limit on the total amount of stock lending. But again, I would be very hesitant to put such a system into place.

I think Rule 204T has done an excellent job of removing most of the settlement failures. If you look at what's left on the threshold list -- I looked yesterday. There were two companies on New York, one operating company on Nasdaq. But there were about 40 approximately exchange traded funds, and this, I think, is the big unsolved problem. And that's one of the reasons why Dr. Shapiro's getting such high numbers for the fails because you do see some very large fails in the exchange traded funds, and that's an issue that the Commission really hasn't addressed.

Now, the ability to short exchange traded funds is absolutely essential for their functioning. And my broker was telling me yesterday I could not short a bunch of those ETFs which happened to be on the threshold list. So there is a market malfunction going on here. Does it have to do with the pre-borrow requirement, the locate requirement or is there some other friction in the ETF creation process? I tend to think it's the latter, but I do think the Commission needs to look at the ETF issue separately from the rest of the stocks.

DR. SHAPIRO: I do think that Dr. Angel is correct that a rule of lending only once would interfere with the ability to lend stock which has been bought for the purchaser of a short sale. However, a hard restriction in the DTCC stock borrow program, that the same shares can only be lent once, I think would make a great deal of sense since there is evidence of churning of shares which are hard to locate in small companies through the stock borrow program.

COMMISSIONER CASEY: Professor Angel, I want to pick up on something that you mentioned earlier which was your belief that price discovery mechanism was broken. And I was hoping you all could comment on your view as to we understand the value of short selling in ordinary times in terms of obviously, the correcting function it plays in overvalued stocks and the efficiency it brings to the market.

Is there something unique or different about short selling behavior in extreme market conditions that we should be concerned with? Does behavior change?

DR. ANGEL: Well, our markets have changed. We've gone from markets in which humans traded with humans to one in which computers trade with computers, and things happen so much faster now that the damage can occur literally within seconds before any human can possibly stop the stock. And so I think that's one of the reasons why we do need some kind of shock absorber that kicks in. Now, exactly what form it should look at -- or what form it should look like remains to be determined. But I think we need a broad public debate on how to deal with it.

But I'd like to state that the price mechanism works very well most of the time. But we do observe these situations like Denedron where it broke, and it doesn't take many of those situations to destroy investor confidence.

COMMISSIONER CASEY: And you're saying that may or may not be attributable to short selling. It could be some other operational issue or something like that that would have the same consequence.

DR. ANGEL: Exactly. I mean I don't have access to the data, but, for example, a large investor who sets up the algorithm to get rid of a large block thinking that they're going to dribble it out 100 shares at a time over the next week may put the wrong time frame into the algorithm and suddenly dump a million shares instantly. Something like that could also trigger a stock to just fall out of bed on short notice.

COMMISSIONER WALTER: Following on that, in our first panel this morning with two issuer representatives, they expressed concern which I read and I'm extrapolating from their remarks, so maybe I've misinterpreted them. But they expressed concern about what I would call the micro distortion on their particular stock which follows on in that idea.

And one of the things that occurred to me in listening to them was whether we've sort of overlooked that. We seem to in this analysis be talking a lot about the health of the market mechanism, what keeps the market going as a whole, but there is also an important value to be served by trying to make sure that there aren't things that are inappropriately disrupting the price discovery mechanism on a company by company basis.

And I wondered if you could react to how we would go about taking that into account in our analysis here in determining what to do.

DR. HATHEWAY: I'll take a jump at that. Maybe pick up Jim's question as well.

In times of market stress, at a macro level, micro level, the opportunities to short under the two proposals, uptick or up bid, don't change much. They decline a little bit but not significantly. What does change is the aggressiveness of short sale, and we're going to do something that's much more detailed than I have with me today which at this point only covers about 12 days. But effectively, the aggressiveness of short selling picks up about 5 percentage points of total volume as the market goes down. Now, what we have differs from OEA's study that they did about the market break so that's one of the reasons I want to be a little cautious here.

Now, to your question, Commissioner Walter, about the micro level. We have in place an approved rule to put in an electronic circuit breaker for trading on Nasdaq. That's a little bit of a problem because it's Nasdaq, and we're -- it's not a national market system. So I think if we can engage on a national solution to the question of sudden price swings in the security that could only be addressed in automated context because, as Jim said, the events of last week, we acted as fast as we can act with human speed, but the damage was done in 45 seconds. You need something the machine can deal with, and as I like to joke with my friends at general counsel, that means we all have to cede authority to the little black box and the programmers which people aren't necessarily comfortable with.

COMMISSIONER CASEY: When you talk about price swings and this was a question about whether we should be concerned about not just extreme price swings on the downside but on the upside.

DR. HATHEWAY: That's definitely. In both cases, you want to tell a story or have a theory about how someone makes money out of it, and I'm not going to sit here and spin my own manipulation stories because we are being recorded and I don't want to give anybody an idea that doesn't already have one. But, yes.

COMMISSIONER CASEY: And one other follow-up on the issue of bench-marking volatility if that were the goal which was to be concerned about creating a shock absorber for excessive inter-day volatility. Obviously, there were restrictions around the world which I think have been mentioned. How much inference or conclusions should we take that there's been significant volatility worldwide and we saw significant stock price declines across the world even with jurisdictions that had short sale price restrictions or not even price restrictions but just restrictions generally? How much inference or judgment should we take about --

DR. SHAPIRO: Well, let me just say one thing and that is that Hong Kong which has one of the strictest short sale regulatory regimes, including a hard pre-borrow and an uptick rule, very broad disclosure and auditing requirements, they experienced much less volatility than other markets. That's only one example, but it is probably the strictest regime in the world.

DR. HATHEWAY: In terms of volatility halts, the Nordic markets which the OMX part of Nasdaq OMX, have volatility halts. They were hit often during the crisis, and these are trading halts. These are not short selling halts because there's no short selling constraints in the Nordic markets. And during the crisis, the exchange and the exchange community and the regulator widened those thresholds rather than narrowing them. So that's one of the downsides of thresholds is they're conditional on what's happening in the market at that time, and they can actually become an impediment if they're too tight.

In terms of the overall decline of the market, they really didn't make much difference. The Nordics had a tough time. The Icelandic, the Swedish banks had a large exposure to the Icelandic banks. A lot of stress on the financial sector securities, so the market certainly went down. But that's a macro event.

Circuit breakers are really designed for micro events, and so as such, they didn't perform as desired and the exchange moved to eliminate them because they were effectively getting in the way of trading.

I think one of the things our markets did exceptionally well, again harking back to '87, they kept going. The morning of the 20th, the second day of the crash, our markets basically shut down. They were open, but they weren't trading. It was the highest stress, boring period I'd ever had in my life, just sort of waiting for the next trade on the floor of the Philly. That did not happen this time. For better or worse, we kept going, and I think it provided an important signal to the public that the markets were still open. If you wanted to raise capital, you could sell equity at the price you saw on the screen. And if you thought this was the greatest buying opportunity you'd ever see, you could do that as well.

DR. JONES: I think it's actually important to point out that most of these circuit breakers are really trading halts in most of these other markets, and so in some sense, they're not really apropos as to what we're considering here. And so I don't think, for instance, that we can look to any of the evidence anywhere else on the presence of a magnet effect to tell us whether there might be a magnet effect here because I think the events -- a trading halt is very different than what we're considering here as a change in who might be able to short sell and when.

And so I personally don't think that we are likely to see any sort of magnet effect if we impose a circuit breaker just because I don't think any of the restrictions that we are contemplating are all that severe other than a ban.

DR. ANGEL: And I'd like to echo that and get back to Commissioner Walter's previous question about the issuer concerned about the short interest in his company. There are really two legitimate concerns that issuers have about short selling. The first is the short term, the micro concern we've talked about that our whole discussion of the uptick rule is all about. It's, yeah, short selling is a good thing, but too much too fast can overwhelm the liquidity in the market. So the first concern is the liquidity exhaustion argument that if we get too much too fast, it'll muck up the market mechanism.

The second concern is a longer term concern in which you have these companies that have had very high levels of short interest and they're engaged in long-term battles with the shorts and they -- you know, accusations fly left, right and sideways about who's manipulating, who's violating what rules. And there what we're discussing here with respect to short selling and the uptick and circuit breakers won't do anything for the short and distort problem that causes many issuers to file many complaints with the SEC.

One of the issues there is that because of the tax treatment of short selling, there's actually a strong disincentive for short sellers to cover their positions. They've already gotten their collateral back after the stock has gone down, but they don't have to realize a gain for tax purposes until they actually cover. So many of them have a financial incentive to stay short forever if they can. And I think that's one of the things that leads to these long-term battles, but I don't think the Commission can really do anything about that.

COMMISSIONER PAREDES: One of the phrases that was used earlier was the kind of micro side of this and you're talking about damage occurring. And I guess my question, though, is if you have a circumstance where the, quote, damage occurs but then it bounces back, right, and so at some point people realize the stock is undervalued for some reason or another. People come in, and so ultimately, in that scenario, that scenario is the one that obtains. You could say fundamentals win the day, although it may take a day or whatever it happens to take.

The other possibility, of course, is that you have, quote, the damage occurring. You have the precipitous drop, and it stays flat which is to suggest perhaps that's actually also reflecting the fundamentals. And so the fundamentals again are perhaps winning the day.

I'm just curious about depending upon what happens in the hours or days that follow, are we talking about a damage occurs, a damage persists? How do we dissect whether that's because of an abuse, whether that's something an uptick would have done something about, whether it ultimately is a reflection of the fundamentals? And another way of asking that in some part is, is to what extent the market itself is, in fact, self-corrective at least over the longer term, if not in a moment-by-moment respect?

DR. HATHEWAY: I think the market again -- now with the ex-trader hat on, I think the market is self-correcting. Not atypically for an economist, I think markets are efficient. Perhaps a little atypically, I think they're efficient because people make them efficient. It doesn't just happen automatically because people assume it can't be inefficient, therefore it says efficient. No, it gets out of line, and somebody pushes it back.

The way I would normally go about considering a aberration in the market is where you have a sharp price change and an equally rapid -- close to equally rapid price recovery, particularly in the absence of news. And I think the harm in those situations comes from the different constituencies that may be taking part in these events as they unfold.

DR. JONES: I think they're actually -- there's another kind of manipulative activity that we should be concerned about. It's not just these short-term reversals. It's a sharp decline followed by some other -- and that sharp decline forcing some sort of corporate act that is taking place at these wrong prices. So for some reason, forcing an equity issue at these abnormally low prices. That, I think is actually -- in some sense, these reversals are just about transfers between investors, but if we're starting to -- you know, we're starting to liquidate a company that should be liquidated or a company is raising equity at the wrong value or making investment decisions based on a stock price that's at the wrong level, that's the kind of manipulation I think that we should be fundamentally, first order concerned about.

COMMISSIONER PAREDES: Can I just ask a quick follow-up on that, though? Which is if I'm in a boardroom, I'm not going to make that decision over a two-minute period of time, right? And so if we actually make that decision because we've seen the stock price stay flat for some extended period of time, how do we separate out whether that's, in fact, what's the company's worth versus some persistent reflection of some manipulation that actually distorts the market and gets us away from the fundamental value?

DR. JONES: I totally agree with you. It's often hard to tell those two things apart, but I guess what I have in mind is something where the stock price falls rapidly and then the board is forced to do something either because they issued one of these death-spiral convertibles or there's some other -- there's some contract out there that forces something bad to happen to this firm. So that's sort of what I have in mind here, where somebody is trading really with an intent to impose this externality on the firm in this bad way.

DR. SHAPIRO: Let me say there certainly is a lot of evidence that the kind of manipulation that Dr. Jones just referred to and described, it may not be common, but it's not rare, either.

Let me also say and maybe this is -- you know, this is - we talked before about whether our approach to this should be the same after the crisis as it should be before. I have to say as an economist that it may be that on average markets are efficient and it may be on average markets are functional, but our markets are clearly, regularly very inefficient and regularly very dysfunctional.

The housing market over the last five years was profoundly dysfunctional. The market in mortgage backed securities was profoundly dysfunctional. The market in credit default swaps was profoundly dysfunctional. We need to approach these issues not in an abstract way, that the neoclassical model of markets tells us that on average in the long run, all the results will be optimal. We need to instead look at each market, look for the dysfunctions or the efficiencies, address those dysfunctions and not be satisfied with a kind of fundamentalist approach that says that in the end the results will be optimal because the results have not been optimal. The results have been fairly catastrophic for tens of millions of people.

And this is a very good point historically to recognize that and figure out in what respects we should follow the course we've been following and in what respects in order to protect the economy and the markets we need to follow a different course.

COMMISSIONER WALTER: Let me follow up on that and come back to something that Professor Angel said because it seems to me that there may be -- and I don't know whether this is right or wrong, but I'll throw this out as an idea, something different today. You talked about the short-term and long-term concerns of issuers. And I'd like to challenge that just a little bit in terms of whether the long-term concern or the what you call the short and distort -- it has a nice ring to it -- isn't also -- hasn't also turned into a short-term concern because you can see an issuer sitting out there. It has as a result of benign or malevolent market pressure been hit extraordinarily badly in a Dendreon kind of way or perhaps not quite that badly, but there is more of a -- as soon as it goes out of sync with the marketplace today because people are so attuned to coming disaster, you could see it taking a long time for an issuer like that to recover the confidence of its shareholder body and its potential shareholder body. And to me, that becomes also a -- perhaps a short-term concern and it may be that some of the things that we're talking about today with limited intrusion into trading strategies and the overall good flow of the marketplace could perhaps address some of those things in some sort of a circuit breaker kind of way unless the intent, the taint associated with the circuit breaker is enough to create the same sort of problem again.

Does anybody have a reaction to that?

DR. HATHEWAY: I don't really think there's a taint any more than there is around any other sort of halt. I mean it's something that happens probably to every company at some point in its life. So in that sense, whether it's a circuit breaker regarding the introduction of short selling or it's a circuit breaker about stock level volatility that halts trading in that stock, I don't think there's a taint.

I think part of the challenge operationally from looking into this ourselves, different stocks have different thresholds, and that's a bit of a problem to communicate into the investing community simply because it's complicated or you take a simple heuristic like 10 percent knowing that certain types of stocks. Low-priced stocks, for example, it's not going to work very well for you. You have to come up with something different.

DR. JONES: I think it's also worth pointing out that everything we're talking about here in terms of manipulation is really -- we can tell a story. We can talk about short and distort as short selling being the form of the manipulation, but almost every story we tell, we can turn it around and there's a long version of that same manipulation story. And so we really should be concerned about both of those equally, I think. And I think it's wrong to really single out the short side of this for special consideration.

COMMISSIONER WALTER: That may be right, but I think on the upside, we've at least been somewhat successful in going after the people who have done this, finding them, determining that it's happened, not always. But there's enough of it that it self serves as a deterrent for those people who are at least somewhat attuned to obeying the rules not to do it. And on the short side, it seems much more complicated, at least to me.

DR. JONES: Do you think you have a harder time identifying -- this is probably a question for the enforcement staff, I think. But it sounds like it might be harder for you all to identify this kind of manipulative activity on the short side.

COMMISSIONER WALTER: Let me say I'd have a hard time identifying either and leave it at that. But yes, it's a question for the enforcement staff. But I do think there is certainly a difference. Maybe we're more attuned to upside manipulation, but if you look historically, look at the number of pump-and-dump cases that have been brought. And all of these things are complicated in an evidentiary sort of way, and maybe it's just because of the greater sophistication in the marketplace. But that's my perception, at least at the moment.

DR. JONES: I guess another possibility is that the short and distort stuff just doesn't happen as often.

CHAIRMAN SCHAPIRO: I wonder if you would agree that one of the other differences between the long side and the short side is that there are many more almost Draconian actions that a corporate issuer will take based on their stock price being depressed for a long period of time. So they might be subject to a takeover. They might feel they have to do a partnership with someone. They might close factories or lay-off employees. I mean, there are a lot of issues I think that have more profound impacts throughout the economy from the short side than there are from the long side, at least that's been my experience.

DR. JONES: I agree that there are these existential things tend to happen more on the short side than they do on the long side, but I think there are plenty of value reducing strategies that happen on the long side. You just have to think back to the Internet bubble and Pets.com and all the Super Bowl ads it bought with its silly sock puppets, right? If we had had -- if we'd basically had a more active, I think, short selling brigade to sort of rein in those kinds of firm, I think we might not have had those value reducing strategies. But your point's well taken, I think.

DR. WERNER: Also, you can think about in a pump-and-dump scheme, a corporation might choose to issue stock at an inflated value, thus destroying investor value as they purchase the stock. So you can think about losses either way. So I agree with Charles that symmetric treatment would be really something to really consider here.

DR. ANGEL: And, however, I'd like to point out and make an argument for asymmetric treatment for the following reason: that with a -- if you look at the real economy, if a stock is undervalued, then the -- as you point out, the company may be forced to take actions. They may be unable to raise financing on affordable terms. Employees who are motivated by stock options may leave the company. You have customers may walk away. And the short sellers have a financial incentive to interfere with the operations of an operating company, and this is one of the reasons why issuers have such a visceral loathing of short sellers.

Now, I'm a great defender of short sellers. That, personally, I don't think they caused our debacle. I actually bought Lehman Brothers a week before they failed as a speculation they would turn around. With retrospect -- in retrospect, I wish there'd been more short selling. If there'd been more short sellers who pushed the price down further faster, I would have lost less money.

So I'm a great defender of the short sellers, but if a stock is truly selling below its true value, it can cause damage to the real economy. And that's why we need to pay attention on the short side.

DR. HATHEWAY: I'll pick up on the symmetry idea just for a second. As was said this morning and by Dr. Shapiro on this panel, disclosure of short positions, I think, is well warranted.

COMMISSIONER CASEY: That was going to be my -- I mean just how much do we buy and increase transparency in terms of addressing the concerns that have been raised today? I know Dr. Werner has suggested that -- and we've heard from other panelists as well that enhanced reporting and disclosure would be valuable. I guess I'm trying to appreciate how much do you think that actually contributes to addressing some of the perceptions and perceptions about the role that short selling is playing?

DR. SHAPIRO: Well, it depends on what the data show. The data could undermine confidence as well as support it, but certainly, as a general proposition, the more disclosure, I think, generally, the more efficient the market is likely to be. There are enormous significant distortions that arise from asymmetries of information. Some people have access to it; others don't. And I think this would reduce those as well increase the general level of information. And it would make the price discovery which occurs under short sales more valuable, frankly.

DR. ANGEL: Whenever you have a lack of transparency, you create room for the conspiracy mongers to think that something bad is going on. So with additional disclosure on how much short selling there is, how much interest there is and what level of settlement failures we're experiencing, I think that transparency will do a lot to restore investor confidence in the market.

And if there is a problem, then the fact that the data are out there and we can all look at the data, I think it will really help the SEC in its enforcement activities to essentially deputize the general public to troll through the data and find the problems.

DR. HATHEWAY: That's an interesting distinction perhaps between real time and exposed transparency. So the fail data was terrific when the Commission began to release that with a one quarter lag. Still having it provides firms and people such as myself and the others on this panel the opportunity to really look at some trading events and try and figure out what's going on as well as to identify strategies.

Real time, you do run the risk of information overload. So there's disclosure and there's informing the investing public, and I think that balance needs to be struck because as Jim and I were talking about at lunch, I could see certain types of real disclosure -- real-time disclosure being used as part -- yet a different form of a manipulation strategy to try and create an appearance that may not necessarily be so.

MR. BRIGAGLIANO: That brings us to the end of the roundtable unless the Commission has further questions?

On behalf of the staff, we'd like to thank all the panelists for their insights, candor and really the enormous effort that it took to be here. Your participation is crucial.

I'd like to turn the program over now to Chairman Schapiro for any closing remarks she may have.

CHAIRMAN SCHAPIRO: Thanks very much, Jamie.

Before closing today's roundtable on short selling, I really want to extend my sincere thanks and those of my colleagues on the Commission to all of you and our panelists this morning. We so appreciate your taking the time, some of you to travel to Washington from other places to be here and really help inform our decision making in this really critical area. We have a lot to think about based on today's conversations.

And we also want to thank my commissioners for your insightful questioning throughout the day.

We are charged with ensuring that the securities markets operate within a regulatory framework that promotes efficiency while protecting investors from the potential abuses and the manipulation that can cause them to lose faith in our very well proven system of capital formation, and we take that charge very seriously across the entire spectrum of securities regulation. And the current debate over short selling policy is certainly no exception.

So for that reason, we are committed to closely reviewing the potential benefits and the costs of our recently proposed amendments to Reg. SHO and their overall impact on investor confidence. I do think that today's candid discussion of highly informed and differing viewpoints will go a very long way in assisting the current rulemaking process.

So in that regard, I would note that the public comment period for the proposed amendments to Reg. SHO will run until June 19th. And I would encourage those here in attendance but also those of you viewing on our webcast to contribute to this ongoing policy discussion and share your viewpoints on the proposed approaches to short selling regulation.

Before we conclude, I want to thank those people at the SEC who also made today's event possible. I'll start with none other than our intrepid moderator Jamie Brigagliano. Thank you, Jamie, for getting us through the day. Also, our short selling roundtable team of JoAnne Swindler, Josephine Tao, Tory Crane, Steward Mayhew, Amy Edwards, Tim McCormick and most especially, Matt Sparkes.

And again, thank you very much to all our panelists for all your help today.

(Whereupon, at 3:10 p.m., the roundtable was concluded.)