

Michael R. Trocchio  
Direct Phone: 202.373.6167  
Direct Fax: 202.373.6467  
michael.trocchio@bingham.com

October 19, 2007

Ms. Nancy M. Morris  
Secretary  
U.S. Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549

**Re: File No. S7-19-07; Release No. 34-56213**  
**Proposed Amendments to Regulation SHO**

Dear Secretary Morris:

On behalf of Credit Suisse Securities (USA), LLC, Deutsche Bank Securities Inc., Lehman Brothers, Inc., Merrill Lynch, Pierce, Fenner & Smith Incorporated, Morgan Stanley & Co., Incorporated, Piper Jaffray & Co., and State Street Global Markets, LLC (the "Firms"), we submit these comments in response to the above-referenced proposal to amend the Commission's Regulation SHO ("Regulation SHO") under the Securities Exchange Act of 1934 (the "Exchange Act"), as published in Securities Exchange Act Release No. 56213 (the "Proposing Release").<sup>1</sup> The Firms are limiting their comments to the Commission's proposal to require broker-dealers to document the location of securities when marking sale orders "long" (the "Long Sale Proposal"). The Firms appreciate the opportunity to comment on the Long Sale Proposal.

## I. Summary

The Firms strongly believe that the Long Sale Proposal should not be adopted for two primary reasons:

1. The negative consequences of adopting the Long Sale Proposal are significant. In many cases, the Long Sale Proposal would materially increase order-entry time, slowing speed of execution and exposing customers to the economic risk of adverse market price movements during the execution delay. In addition, the Commission has severely underestimated the Long Sale Proposal's significant burdens on broker-dealers, including complex, costly and time-consuming programming changes. The Long Sale Proposal would also impose burdens on non-broker-dealers such as money managers and systems vendors which the Commission has ignored.

---

<sup>1</sup> Securities Exchange Act Release No. 56213 (August 7, 2007), 72 FR 45558 (August 14, 2007).

2. The benefits of the Long Sale Proposal are unclear. The Commission has not presented any evidence that there is a problem with the accuracy of orders marked “long,” nor has the Commission presented any information suggesting that mismarked long sale orders have led to problems such as material failures to deliver. Furthermore, the Commission has not demonstrated that the Long Sale Proposal would address its perceived concerns and result in a significant decrease in mismarkings and associated problems.

From an economic perspective, the Long Sale Proposal does not appear to be the result of an impartial economic analysis demonstrating that an amendment is necessary; rather, the economic analysis in this matter is a flawed, after-the-fact rationalization designed to support a pre-conceived policy result. Simply stated, the Commission has not adequately demonstrated the benefit of the Long Sale Proposal despite its assertion in the Proposing Release that the costs “would be justified by the benefits of a [long sale] documentation requirement.”<sup>2</sup>

It is well documented that the implementation of Regulation SHO in 2005 has significantly reduced fails to deliver.<sup>3</sup> The Commission has taken further steps this year to reduce fails by eliminating the “grandfather” clause of the “close-out” requirement, effective October 15, 2007, an amendment that is widely expected to reduce persistent fails to deliver even further. The decision to eliminate the “grandfather” clause was made following an extended period of examination and review. Rather than rushing to adopt this further amendment that will delay execution, impose significant costs on broker-dealers and other persons, and lacks a demonstrated benefit, the Firms believe the Commission should give the elimination of the “grandfather” clause a chance to work, then consider conducting a review of the need for the Long Sale Proposal. Such a review should specifically evaluate mismarkings and resultant problems such as fails to deliver, consider regulatory alternatives to address any problems that may be identified, and evaluate the overall costs of the problem(s) and solutions to investors, broker-dealers and the securities industry as a whole.

## II. Former NASD Rule 3370, Current Regulation, and the Long Sale Proposal

### A. Regulation SHO Generally and the Long Sale Proposal

Regulation SHO became effective January 3, 2005<sup>4</sup> and is the Commission’s primary regulation relating to short sales, especially since the elimination of short sale price tests earlier this year. The focal point of Regulation SHO is ensuring that securities are available for delivery on sales and that fails to deliver are closed-out. Among other

---

<sup>2</sup> 72 FR at 45571 and 45583.

<sup>3</sup> Securities Exchange Act Release No. 54154, 71 FR 41710, 41711.

<sup>4</sup> Securities Exchange Act Release No. 50103 (July 28, 2004), 69 FR 48008 (August 6, 2004) (the “Regulation SHO Adopting Release”).

things, Regulation SHO sets forth specific requirements relating to broker-dealers' acceptance of sale orders, including the meaning of ownership, how to calculate net positions, when a sale may be marked "long" or "short," what steps must be taken to increase the likelihood of delivery on a sale, and what, if any, documentation requirements apply. The only express documentation requirement of Regulation SHO relates to short sale orders. Specifically, in connection with accepting/effecting a short sale order, Rule 203(b)(1) requires that broker-dealers document either: 1) that the seller has borrowed or entered into a bona-fide arrangement to borrow the security, or 2) reasonable grounds to believe that the security can be borrowed in time for delivery.

Currently, Regulation SHO permits broker-dealers to mark orders "long" without documenting the current location of the securities to be sold. The Long Sale Proposal would create an express documentation requirement for long sales by amending Rule 200(g) to require that broker-dealers "document the present location of the security being sold" for all long sale orders. This amendment would require all broker-dealers to create and maintain, for at least three years, a separate record specifying the location of all shares to be sold with respect to every customer and proprietary long sale order.

#### B. Former NASD Rule 3370

Prior to the adoption of Regulation SHO, former NASD rule 3370(b) imposed certain obligations on NASD member firms when accepting/effecting long and short sale orders. Like the Long Sale Proposal, former rule 3370(b) included a documentation requirement relative to long sale orders; however, former rule 3370(b) applied only to a narrow subset of long sale orders, making it much less burdensome than the Long Sale Proposal. NASD repealed rule 3370(b) when Regulation SHO became effective because Regulation SHO established specific requirements relating to the same areas covered by the NASD rule.<sup>5</sup>

### III. Significant Negative Consequences and High Costs of the Long Sale Proposal

The Firms believe the Commission has overlooked and/or underestimated the significant negative consequences associated with the Long Sale Proposal and substantially underestimated costs that greatly exceed the Commission's projections. These negative consequences include substantial delays in execution time and high costs to program, test, implement and coordinate systems to comply with the rule as well as to verify compliance and maintain records. These consequences may have a material adverse effect on investors, brokerage firms and others involved in the securities industry including asset managers, technology vendors and market centers. As a result, the Firms believe the Long Sale Proposal should not be adopted.

---

<sup>5</sup> See, NASD Notice to Members 04-93. See also, Securities Exchange Act Release No. 50822 (Dec. 8, 2004), 69 FR 74554 (Dec. 14, 2004).

A. Delayed Execution Time

The Commission has failed to recognize that the most significant harm of the Long Sale Proposal is that tens, if not hundreds, of millions of customer long sale orders annually will suffer delayed execution as broker-dealers and/or their customers try to document the location of securities. As the Commission has historically recognized, execution time is a critical factor in assessing quality of execution.<sup>6</sup> The time spent documenting the location of shares for long sale orders will delay execution and expose customers to adverse market price movements during the delay. This delay will be quite significant where the executing broker does not maintain the customer's account and even more significant where the securities are in multiple locations (*e.g.*, where a portfolio manager submits an order relative to numerous customers who hold securities in multiple locations).

In performing its cost-benefit analysis, the Commission failed to calculate the economic harm of the Long Sale Proposal in terms of decreased execution quality caused by this delay. Many securities, especially actively traded ones, have multiple quote changes per second. Even if the Commission were correct in its estimates that only 2 billion long sales per year would need to be documented at 0.5 seconds per sale (a time frame that the Firms think is unrealistic), there would still be tens (if not hundreds) of millions of customer orders that would be getting worse executions in falling markets.<sup>7</sup> Moreover, in those instances where the recording of location information takes many seconds, if not minutes, the costs to customers in terms of worse execution prices are magnified. The Commission has not recognized or attempted to estimate this customer harm. The failure to take into account this substantial harm is a fundamental flaw in the Commission's rulemaking effort.

---

<sup>6</sup> "The Commission has historically analyzed a broker's best execution obligation on the basis of several factors, including execution price, *speed of execution*, the size of the order, the trading characteristics of the security involved, the availability of accurate information affecting choices as to the most favorable market center for execution and the availability of technological aids to process such information, and the cost and difficulty associated with achieving an execution in a particular market center." Regulation NMS Adopting Release, Securities Exchange Act Release No. 51808 (June 9, 2005), 70 FR 37496, 37642 (June 29, 2005) (emphasis added) (Atkins, C. and Glassman, C., dissenting).

<sup>7</sup> Even if the Commission were correct that only 2 billion long sales per year needed to be documented, assuming 1/3 of these sales were delayed enough for the price to move adversely \$0.01/share and the average order is for 1,000 shares, that would be \$6.66 billion in harm per year. Although this is only a very rough guess as to harm, the example shows how easily time delays can lead to billions of dollars in harm over the course of a year.

B. The Commission's Incorrect Estimate of the Burden

The Commission stated in the Proposing Release that the costs of its Proposal "would be minimal because ... [broker-dealers] already must ascertain whether the customer is 'deemed to own' the securities being sold before marking a sell order 'long'"<sup>8</sup> and "to the extent that there are any, would be justified by the benefits of a [long sale] documentation requirement."<sup>9</sup> The Commission has estimated that the Long Sale Proposal would impose, on average, a burden of 49 hours per year on each of 5,808 U.S. broker-dealers. The Commission reached this estimate by assuming that broker-dealers would automate the documentation requirement, and that such automated documentation process would take 0.5 seconds per order with respect to 2.063 billion long sales per year. The Commission also estimated that it will cost the average broker-dealer \$1,072 (16 hours at \$67/hour) to make necessary program changes to accommodate the Long Sale Proposal. The Commission's estimates of the programming costs and on-going time burden (49 hours per firm per year) are highly inaccurate and based upon a number of mistaken beliefs.

1. The Commission's Estimate of Impacted Orders is Incorrect

The Commission incorrectly estimated that the burden of the Long Sale Proposal would apply to 2,062,500,000 long sales annually (75% of 2,750,000,000 trades). First, these numbers are directly contradicted by the data cited by the Commission in the Proposing Release - specifically, that in 2006 there were 4.213 billion trades in NYSE, Nasdaq, and OTCBB securities (even this number excludes transactions in Amex-listed and "pink sheet" securities).<sup>10</sup> Second, regardless of the number of trades in 2006, the Firms believe using 2006 data as a proxy for trades in 2008 (the first year the Long Sale Proposal could reasonably be expected to apply) and beyond is a mistake, especially considering the fairly constant upward trend in aggregate trading volumes and the increase in orders and transactions resulting from Regulation NMS (new in 2007).

Furthermore and most significantly, the Commission's estimate of the burden should be based upon the number of long sale orders broker-dealers accept/route per year, rather than long sale transactions because the burden of the Long Sale Proposal relates to all long sale orders whether or not a transaction results from the order. The Firms believe the number of orders received by, or originated from, broker-dealers is a substantial multiple of the number of trades actually effected. For these reasons, the Firms believe the Commission's estimate of the number of orders affected by the Long Sale Proposal is a gross underestimate.

---

<sup>8</sup> 72 FR at 45583.

<sup>9</sup> 72 FR at 45571 and 45583.

<sup>10</sup> *See*, Proposing Release, 72 FR at 45575, footnote 113.

2. The Long Sale Proposal is Much More Burdensome than Former NASD Rule 3370

In support of its belief that the Long Sale Proposal would not be overly burdensome, the Commission notes that former NASD rule 3370(b) also imposed a long sale documentation requirement upon broker-dealers. The Commission stated in the Proposing Release that broker-dealers should already be familiar with its requirements and that “[s]uch familiarity should help reduce any costs associated with implementing”<sup>11</sup> the Long Sale Proposal. The Firms respectfully disagree. Comparison to the burden of former NASD rule 3370(b) is inappropriate because it applied to a much narrower set of long sale orders than the Long Sale Proposal would.

Under former rule 3370(b), there was no documentation requirement for long sales where (1) the broker-dealer had possession of the security, (2) the customer had a long position on account with the broker-dealer, or (3) the security was on deposit in good deliverable form with another broker-dealer or a bank and instructions had been given to the custodian to deliver the securities against payment. The Long Sale Proposal would apply in all three of these circumstances. Former rule 3370(b) only required documentation of the location of a security to be sold long in a single circumstance - where the broker-dealer made an affirmative determination that the customer owned the security and would deliver in good deliverable form by settlement date. Thus, the significant majority of long sale orders did not have a specific documentation requirement under former rule 3370(b). By not including these exceptions in its Long Sale Proposal, the Commission is proposing dramatically more onerous requirements than ever existed in rule 3370(b).

3. Compliance with the Long Sale Proposal is Not Comparable to Marking Orders “Long” or “Short,” Nor is it Comparable to the Locate Process

The Commission stated in the Proposing Release that its 0.5 second estimate is based upon the fact that the Commission had previously estimated it would only take 0.5 seconds to mark an order “long” or “short”<sup>12</sup> so that it is reasonable to assume it would take a similar amount of time to document the location of the securities if the documentation process were automated.<sup>13</sup> Analogy to the time necessary to mark an order “long” or “short” is not appropriate. Marking a sale as “short” merely requires a very brief notation such as “SS,” circling a short sale indicator on a ticket, or selecting “short sale” from a drop-down menu in an electronic order entry system. Marking sales as “long” requires similarly little effort. The information required to be recorded in connection with the Long Sale Proposal is in no way comparable to marking a sale as “long” or “short” because the possible locations across all market participants are so numerous as to be almost countless. An automated system would have to include every

---

<sup>11</sup> 72 FR at 45583.

<sup>12</sup> 72 FR at 45575, footnote 115.

<sup>13</sup> *Id.*

possible prime broker, custodian or other entity that could hold securities on behalf of a customer. Such an automated system would also have to accommodate multiple locations as customers may have their securities held at more than one entity. It would also have to accommodate circumstances where the customer's securities are held at a location that was not contemplated by the system. As a result, there is no universal "short-hand" notation, there can be no pre-printed order tickets, nor can firms practically offer a comprehensive electronic drop-down menu of locations. Rather, in each case, the person entering the order will have to manually write, or enter in to an electronic system, the location(s) of the securities to be sold (and this would take much longer than 0.5 seconds).

In further support of its belief that the establishment of electronic systems to comply with the Long Sale Proposal will not be expensive or burdensome, the Commission noted in the Proposing Release that Regulation SHO already requires broker-dealers to document compliance with the "locate" requirement ... [thus] broker-dealers should already have in place systems similar to those necessary" to comply with the Proposal.<sup>14</sup> The Commission is not correct. Compliance with the "locate" requirement generally is facilitated through the daily preparation of a list of securities that may be shorted (usually in the form of an easy-to-borrow list) based upon a determination that such securities are available to be borrowed for delivery on short sales. In such a case, this determination is made before the start of the trading day, and this determination suffices for all short sale orders received in those securities that day. When accepting short sale orders in a security that is on such a list, no further documentation is required. In the majority of cases, broker-dealers make the use of such lists even easier by loading them into their order-entry systems so that review of the list is automated upon entry of a short sale order. For the vast majority of short sale orders, then, there is no manual order entry requirement for the locate information.

With respect to the Long Sale Proposal, it is highly impractical, if not impossible, to create a list of locations that may be checked when accepting a long sale. The burden of the Long Sale Proposal is much more comparable to the burden of the "locate" requirement in cases where the security is not on an easy-to-borrow list - a time-intensive matter that can take many minutes and requires manual entry of the locate information either by the customer, broker, or stock lending department. In some cases, even in the absence of an easy-to-borrow list, it is actually easier and faster to comply with the "locate" requirement than it would be to comply with the Long Sale Proposal. Specifically, when an executing broker receives a short sale order from a customer without locate information, the executing broker has the option to perform its own locate (either by relying on an easy-to-borrow list or performing a specific locate) without having to contact the customer for additional information. This option does not exist with respect to long sale orders received by executing brokers - if the location information is not provided, the order must be delayed while the executing broker contacts the customer to try to collect the information.

---

<sup>14</sup> 72 FR at 45575, footnote 115.

Stated differently, the short sale “locate” requirement is managed in a fairly efficient manner today because broker-dealers are empowered to independently employ tools (like easy-to-borrow lists) within their control to speed and facilitate the locate process. Conversely, the Long Sale Proposal would introduce a great deal of friction into the order entry process by squarely placing the client, and the client’s knowledge as to the present location of its securities, at the center of each determination made regarding a long sale. That is a significant change to the way business is conducted in the U.S. equity markets today.

#### 4. Compliance with the Long Sale Proposal Cannot Be Fully Automated; Modifications to Electronic Order-Entry Systems Would Be Expensive and Time-Consuming

The Commission’s estimate of burden hours hinges on the belief that the process will be automated, and that as such, the time burden will be 0.5 seconds per long sale. The Commission has estimated that “[t]o the extent that broker-dealers need to automate the documentation process ...reprogramming burdens at a broker-dealer would be approximately 16 hours (or two days) with one programmer.”<sup>15</sup> This estimate is based, in part, on the Commission’s belief that “most of the relevant information is already stored in electronic form and, therefore, [the Commission does not] believe that the automation process would be difficult or time-consuming.”<sup>16</sup> The Firms believe strongly that compliance with the Long Sale Proposal cannot be fully automated, and any systems changes necessary either to partially automate the system or to capture information that must be entered manually will be expensive and time-consuming.

The Firms are not aware of any automated system that currently functions to take into account all possible security locations across all market participants, which functionality would be a predicate to generating the record required by the Long Sale Proposal. Further, the contemplated process can only be truly automated in those limited circumstances where the broker-dealer already has the location information in electronic format (*i.e.*, where the firm holds the securities in a proprietary or customer account). Therefore, any expense incurred in automating the process with respect to such long sale orders would be incurred to create a duplicate of existing electronic records. The expense to create an automated system where the broker-dealer has possession of the security to be sold long will dwarf the Commission’s \$1,072 estimate and will not address systems changes to permit for the manual entry of location information.

Other than where the broker-dealer already has all the location information in electronic format, the documentation process will, by necessity, have a manual component where a person will have to enter the location information, and this will entail time costs well in excess of 0.5 seconds. The vast majority of electronic order-entry systems are not configured to accept the information that would need to be entered to comply with the

---

<sup>15</sup> 72 FR at 45575.

<sup>16</sup> *Id.* at footnote 116.



Long Sale Proposal. In order to capture the unique information required by the Long Sale Proposal, all order-entry systems, whether offered by an exchange, ATS, broker-dealer, or third-party vendor would have to be modified to offer a "field" where the location of securities may be entered, but the costs to modify scores of such platforms would be extremely high and the entry of the location information would still be a manual (*i.e.*, time-consuming) process. Customers and vendors may need to make changes to the screens where long sales are entered, map the data entered in such screens to a validation process, and further map the data to the network messaging system. On the receiving firm side, either the firms or the vendors will need ensure that their systems capture the data from the network messaging system and have a field on their front end system to capture such information for manual orders. In addition, the receiving firms or their vendors will need to perform a validation (this is probably the most challenging part, particularly where multiple custodians are involved) of this information and retain the information. The Firms believe the extensive nature of the changes necessary would take more than a year at a very substantial cost.

5. The Long Sale Proposal Would Entail Very Manually Intensive Recording of the Location of Securities Where the Executing Broker is Not the Custodian

The Long Sale Proposal will be especially burdensome on executing brokers and their customers in prime brokerage arrangements (and similar arrangements where the executing broker is not the custodian of the securities to be sold). It is in this context that the most time will be spent by both broker-dealers and their institutional customers providing/recording location information and the greatest harm will be realized (harm both in terms of speed of execution and lost productivity).

Most institutional business is conducted in the context of prime brokerage or DVP/RVP arrangements where customers' securities are on deposit with a prime broker or agent bank, but orders are submitted to the trading desks at executing brokers that have no knowledge of their customers' positions. Indeed, most clients with prime brokerage relationships insist that the trading desks of their prime brokers (and elsewhere) not have any visibility or access to the aggregate positions custodied at the prime broker. Hundreds of executing broker-dealers sell securities for institutional customers that have either appointed agent banks to custody their securities or that have their securities on deposit with a prime broker (or prime brokers) different from the multiple executing brokers used by each such institutional customer. Under the Long Sale Proposal, virtually every order entered with an executing broker in these arrangements would require the manual entry of the location of the securities. Further aggravating the matter is the fact that, in some cases, these securities positions are held by multiple custodians. The time spent trying to comply with the Long Sale Proposal would slow down greatly the order-entry process and significantly impair execution times for many customers.

Both under former NASD rule 3370(b) and Regulation SHO, executing brokers have been accepting most long sales of securities by institutions without documenting the location of the stock sold long. In a significant majority of cases, the executing broker knows the customer's agent bank or prime broker and reasonably believes the security is

on deposit with that institution in good deliverable form unless there exists a reason to believe otherwise. The Long Sale Proposal completely reverses long-standing industry practice conducted in accordance with former NASD rule 3370(b) and Regulation SHO.

#### 6. Direct Market Access Systems

The Commission's estimate of the cost of the Long Sale Proposal does not recognize the prevalence of direct market access ("DMA") arrangements in which broker-dealers do not humanly touch a customer's order prior to its entry and execution. In a typical DMA arrangement, a broker-dealer offers a customer access to market centers by enabling the customer to electronically route orders to market centers in the broker-dealer's name. The advent of DMA was driven by clients' desire to transact as quickly as possible without incurring delays brought on by human intervention and order handling. In these circumstances, the burden of the Long Sale Proposal will fall on customers to enter the information and broker-dealers to check the accuracy of order marking after the trade has been routed. The Commission's estimate of the burden does not recognize the time-burden on customers in entering this information and it should.

#### 7. Other Costs

The Commission's estimated burden/costs associated with the Long Sale Proposal excludes a number of other relevant items, including:

- the time and cost burden on customers (especially money managers and others who trade on behalf of multiple clients) who must supply the information to their broker-dealers;
- the costs imposed upon each of the dozens of companies that offer a front-end platform for order entry estimate that will need to modify their systems;
- the costs of data storage for billions of records for several years;
- the costs of training and compliance monitoring, as well as revisions to policies and procedures;
- the costs of responding to regulatory inquiries relating to compliance with the Long Sale Proposal (the costs of complying with regulatory inquiries during the past two years relating to the "locate" requirement have been substantial based on the Firms' direct experience);
- the time spent by broker-dealers educating customers on the new requirements for entering long sale orders; and
- the likely loss of transaction volume to overseas venues: the Firms believe that if the Long Sale Proposal were adopted, U.S. institutional customers may, where possible, send their orders to overseas broker-dealers and markets to avoid the

burden and delay (and associated risk of price movement) of entering orders with U.S. broker-dealers.

These burdens and costs are not reflected in the Commission's analysis in the Proposing Release, and the Firms believe the Commission should consider them when determining whether to adopt the Long Sale Proposal.

#### IV. Little, if Any, Demonstrated Need or Benefit for Documentation of Long Sale Orders

The Commission has not provided any information suggesting that there is a problem with the marking of orders, and more importantly, that mismarked "long" orders have led to problems such as failures to deliver of any significance. Moreover, the Commission has not demonstrated that the Long Sale Proposal will address its perceived concerns and result in a decrease in mismarked orders and failures to deliver. In the absence of any such evidence or information, the significant costs of the Long Sale Proposal cannot be justified, despite the Commission's blanket assertions in the Proposing Release that the costs would be justified by the benefits.<sup>17</sup> The Firms strongly believe, therefore, that the Long Sale Proposal should not be adopted.

##### A. No Evidence of Mismarking or Related Problems such as Failures to Deliver

The Commission listed three very similar reasons in the Proposing Release in support of the Long Sale Proposal, as follows:

1. The Long Sale Proposal "would aid in ensuring the correct marking of sell orders..."<sup>18</sup>
2. The Long Sale Proposal "would help ensure that the broker-dealer marking the sale "long" has inquired into, and determined that, the seller is "deemed to own" the securities being sold ..." <sup>19</sup>
3. The Long Sale Proposal "would enable the Commission and SROs to examine for compliance with the long sale marking provisions of Rule 200(g) more effectively ..." <sup>20</sup>

These three items may be fairly summarized as a single purpose for the Long Sale Proposal - to increase the accuracy of orders marked "long." The Commission has not

---

<sup>17</sup> 72 FR at 45571 and 45583.

<sup>18</sup> 72 FR at 45571.

<sup>19</sup> 72 FR at 45572.

<sup>20</sup> *Id.*

claimed in the Proposing Release, nor provided any factual basis to believe, that there is a widespread or chronic “long” order marking problem. More importantly, the Commission has not provided any information suggesting that a material amount of fails to deliver or other problems (*e.g.*, evasion of Rule 105 of Regulation M) can be attributed to sales incorrectly marked “long.”<sup>21</sup>

For commenters to evaluate the Long Sale Proposal, the Commission needs to quantify the extent to which problems such as failures to deliver can be attributed to orders improperly marked “long” and the extent to which the Long Sale Proposal can be expected to prevent such problems. Because no information has been provided in the Proposing Release to establish an order marking problem and corresponding problems such as fails to deliver, and no information has been provided to illustrate how the Long Sale Proposal would address such issues, the Firms do not understand how the Long Sale Proposal is necessary or appropriate in the public interest nor how it promotes efficiency, competition or capital formation.<sup>22</sup> If there is not a substantial order marking problem and corresponding problem such as failures to deliver, then the Firms do not believe there can be a justifiable benefit from the Long Sale Proposal.

If the Commission has information suggesting that orders are persistently being marked “long” incorrectly and causing significant delivery failures or other problems, the Commission should provide this information to the public and afford it an opportunity to comment as the Commission did in response to comments on its 2006 proposal to narrow the options market maker exception to the close-out requirement.<sup>23</sup> If the Commission does not have this information, it should not pursue the Long Sale Proposal and should instead undertake a thorough study of the matter before proposing further amendments to

---

<sup>21</sup> The only reference to preventing failures to deliver in connection with the Long Sale Proposal is a statement in the Proposing Release that the proposal “could also reduce the number of fails to deliver because, after making the inquiry into the present location of the securities being sold, a broker-dealer would know whether or not it needed to obtain securities for delivery.” 72 FR at 45572.

<sup>22</sup> The Commission stated in the Proposing Release that the Long Sale Proposal “would promote price efficiency by reducing non-compliance with short sale regulations, such as Rule 105 of Regulation M” but provides no evidence of any such non-compliance. The Commission also stated that the Long Sale Proposal “would have minimal impact on the promotion of capital formation [because] [l]arge and persistent fails to deliver can deprive shareholders of the benefits of ownership, such as voting and lending” but provides no evidence that mismarking of long sales has led to fails or that the Long Sale Proposal would reduce fails. 72 FR at 45585.

<sup>23</sup> *See*, Securities Exchange Act Release No. 55520 (March 26, 2007), 72 FR 15079 (March 30, 2007) (re-opening the comment period for the 2006 proposed amendments to Regulation SHO in response to comments that the Commission did not make available for public comment the data relied upon in the proposal).

Regulation SHO.<sup>24</sup> Consequently, the Firms believe the Long Sale Proposal should not be adopted, especially in its overbroad and very burdensome form.

B. The Long Sale Proposal Does Not Eliminate the Need to Rely on Representations from Customers

The Firms do not believe the Long Sale Proposal will substantially improve order marking as it will not eliminate broker-dealers' need to rely on representations from customers and monitor for fails. Broker-dealers are already under an obligation to have a reasonable basis for accepting a "long" sale order from a customer. In circumstances where a broker-dealer does not have custody of the customer's account, the broker-dealer must rely on representations from the customer that it owns the security, and the broker-dealer must assess whether the broker-dealer will be able to make on-time delivery in light of the broker-dealer's experience with the customer. In light of this obligation, most broker-dealers already have procedures in place to determine whether a customer fails in connection with an order marked "long" and whether future representations by such customer may be trusted. The Firms believe that these after-the-fact reviews are valuable in ensuring the primary goal of Regulation SHO - delivery of securities - and that increasing the documentation requirement through adoption of the Long Sale Proposal will not make the reviews more effective.

Under the Long Sale Proposal, broker-dealers will still need to rely on representations from their clients, when reasonable, and afterward, check the veracity of their representations. The only practical way to do so is to review for fails to deliver. Therefore, the Firms question whether Long Sale Proposal adds any value that does not currently exist.

V. Conclusion

In light of the foregoing, the Firms strongly believe that the Long Sale Proposal should not be adopted. The Firms appreciate this opportunity to comment and the Commission's consideration of their comments. Representatives of the Firms would be happy to discuss

---

<sup>24</sup> The Firms suggest that any study by the Commission of failures to deliver should wait until after the effects of the elimination of the "grandfather" clause (effective October 15, 2007) can be measured. The Firms respectfully submit that after the elimination of the "grandfather" clause, there may be little need to adopt another amendment (particularly a highly burdensome one) aimed at ensuring delivery of securities.

Nancy M. Morris  
October 19, 2007  
Page 14

their comments with the Commission or its staff. If you have any questions or would like to discuss this matter with the Firms, please contact me.

Sincerely yours,



Michael R. Trocchio

cc: The Hon. Christopher Cox, Chairman  
The Hon. Paul Atkins, Commissioner  
The Hon. Annette Nazareth, Commissioner  
The Hon. Kathleen Casey, Commissioner  
Dr. Erik Sirri, Director, Division of Market Regulation  
Robert L.D. Colby, Deputy Director, Division of Market Regulation  
James Brigagliano, Associate Director, Division of Market Regulation  
Josephine Tao, Assistant Director, Division of Market Regulation  
Victoria Crane, Branch Chief, Division of Market Regulation  
Elizabeth Sandoe, Branch Chief, Division of Market Regulation  
Joan Collopy, Special Counsel, Division of Market Regulation  
Lillian Hagen, Special Counsel, Division of Market Regulation  
W. Hardy Callcott, Bingham McCutchen LLP