The Security Traders Association of New York, Inc.

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January 13, 2004 S7-23-03

Jonathan G. Katz
Secretary
Securities and Exchange Commission
450 Fifth Street, NW
Washington, DC 20549-0609

Re: Release No. 34-48709; File No. S7-23-03; Proposed Rule: Short Sales

Dear Mr. Katz:

The Security Traders Association of New York ("STANY")[1] submits this letter in response to the above captioned release (the "Short Sale Rule") published by the Securities and Exchange Commission ("SEC" or "the Commission") for comment. STANY believes that short selling serves a valuable function in the marketplace by providing liquidity and a balance to the sometimes over exuberance of purchasers of securities. [2]Speaking on behalf of the majority of our membership, STANY supports a uniform Short Sale test across all marketplaces. Likewise, we are in favor of the suspension of operation of the proposed uniform bid test for certain securities for the qualified two-year pilot period. Despite our general agreement with the changes outlined in File No. S7-23-03, STANY has several concerns with the rule as proposed. Given the limited comment period and the breadth and scope of the proposed rule changes, we have restricted our comments to those areas most directly affecting our membership.

Bid Test- NASDAQ Bid Test Preferred

STANY supports a uniform bid test across all marketplaces. We believe that, in a volatile market, bids move less often than ticks and are easier to read. While we support a uniform bid test, we would strongly urge the adoption of a model built on the current NASDAQ bid rule. The NASDAQ bid rule has been in effect since 1994 without any negative consequences.

[1] STANY is an affiliate of the Security Traders Association ("STA"), a worldwide professional trade organization for equities traders. With close to 2,000 members in the New York metropolitan area, STANY is the largest STA affiliate. STANY works to improve the ethics, business standards and working environment for members, who are engaged in the buying, selling and trading of securities.

[2] See speech by Commissioner Cynthia A. Glassman before the Security Trader's Association (October 16, 2003) which she stated that: "In the category of creating a more level playing field, the Commission will consider next week a proposal to liberalize short sale regulation by moving from a tick test to a bid test. Most economists - and I am one of them - believe that short selling provides valuable services to the market and that current restrictions on short selling, at least with respect to highly liquid securities, are unnecessary. In the last few years, we've seen how much money investors can lose when bubbles cause prices to get out of line. Short sellers trading in these circumstances push prices back, and their efforts thereby limit the investor losses associated with these events. I have seen some preliminary results of a study by our Office of Economic Analysis showing the important role short sellers play in reducing the volatility that can lead to investor losses. So I am pleased to see that Market Reg is proposing a pilot program that would suspend the price test for a group of highly liquid securities. If we do a pilot, the results of the pilot will help inform our decisions going forward - we will be able to see if the theory works in practice."

Moreover, OTC desks at trading firms are currently programmed to comply with its provisions. On a cost/benefit basis, implementation across markets of a test modeled on the current Nasdaq bid test is preferable. The rule as proposed would require the expenditure of tremendous amounts of time and money on technology changes to guarantee compliance. Since many firms and service providers have in place the technology needed to comply with the NASDAQ bid test, adoption of such a plan would reduce the time needed to comply with changes in the SEC's rule. Trading firms and the vendors who service them, would be greatly assisted by the implementation of a bid test in line with the current NASDAQ test. At the same time, we see no negative implications to adoption of a bid test based on the current NASDAQ model. STANY supports the expansion of the Rule to cover all securities where quotes are widely disseminated. We believe that the focus of short sale regulation should be on the less capitalized issuers that have been subject to "bear raids" and manipulation in the past.

Proposed Pilot Program is Unnecessarily Long and Should Include Less Liquid Securities

STANY strongly favors the implementation of a pilot program suspending the operation of the proposed bid test for certain securities with the aim of determining the necessity of a uniform bid test rule. However, STANY believes that a two-year pilot period is unnecessarily long. As a number of markets and ECNs permitted unrestricted short selling during the past year, information is currently available to the Commission regarding trading of NASDAQ securities without the restriction of a short sale rule. Moreover, STANY believes that a six-month test would provide sufficient additional market data for the Commission to assess the effects of unrestricted short selling and determine whether a uniform bid test is necessary for liquid securities

STANY also believes that more securities should be included in the pilot program. Specifically, we recommend the inclusion of less liquid securities in the pilot. The inclusion of less liquid NASDAQ NMS and Listed securities, would provide the Commission with data which would enable it to make a determination as to whether a uniform bid test is a regulation necessary to ensure the accomplishment of the objectives of short sale regulation

As the currently proposed uniform bid test is not applicable to Nasdaq SmallCap (SmallCap) and Over-the-Counter (OTC) securities[3], STANY questions the need for the application of the test to NASDAQ NMS and Listed securities. If the Commission had determined that a uniform bid test is not necessary to obtain the stated objectives of short sale regulation in markets that are less transparent, less liquid and historically more likely to be the subject of manipulation, it is difficult to understand why the Commission sees the necessity for a uniform bid test for liquid or illiquid NASDAQ NMS and Listed securities. STANY respectfully requests that the Commission limit the time of the pilot program, but increase the scope of the pilot so that the data available to the Commission is truly meaningful.

Retention of the Market Maker Exemption

STANY opposes the proposed elimination of certain exemptions that currently exist in the tick and/or bid test rules. Not only do we believe that the retention of the market marker exception is important, we also encourage the adoption of new exemptions as discussed below.

The current market maker exemption to Short Sale Rule enhances the quality of executions received by customers. This exemption allows market makers to access the market on a continuous basis. As such it is a price discovery mechanism that allows the market maker to provide its customers with capital commitment at optimal levels. Without this continuous price discovery, market makers will be unwilling to provide the same level of execution quality. An informal poll of the STANY membership shows that many market makers will be unwilling to commit capital at the levels at which they presently do if the market maker exemption to the short sale rule were eliminated. We believe this to be the same position taken by the NASD in 1997 and cited in the Commission's Proposal. We agree with the NASD's arguments and believe the Staff is incorrect in its suggestion

[3] The Commission supports the exemption of SmallCap and OTC securities from the uniform bid test based on the fact that the short sale rule has not been applied to these securities in the past and that the proposed locate and delivery rules will prevent naked short selling of these securities. Securities Exchange Act Release No. 48709 (October 28, 2003); 68 FR at 62981 (November 6, 2003).

that most sales occur above the bid.[4] The SEC's citation to a NASD study that stated that a low percent of transactions occurred below the bid did not account for the effects of decimalization. [5]Elimination of the market maker exemption will likely cause the decline of capital commitment into the marketplace; result in a decrease of block trading, and ultimately hurt liquidity. A limited market maker exemption as proposed by the Commission would not allow market makers to test liquidity levels at all times, thereby effecting the ability of market makers to most effectively price securities for their customers.

While elimination of the market maker exemption will likely have a negative impact on the willingness of firms to commit capital, retention of the market maker exemption will not impede the objectives of the proposed Short Sale Rule. The concerns of short selling abuses perpetrated by market makers have historically focused on Nasdaq SmallCap and non-Nasdaq securities.[6] The current proposal does not focus on this market segment; rather it seeks to regulate the highly liquid segment that is unlikely to be the subject of manipulation or "bear raids".

We note that the SEC has determined in Regulation M that manipulation in liquid securities is less likely, therefore, exempting actively traded securities from many of the restrictions of that Rule. The securities that the proposal covers are virtually all actively traded securities under Regulation M. While we are not advocating that elimination of the short sale rule for all actively trade securities, we believe that market makers in these securities should be exempt from any short sale rules.

Expansion of Exemption to Block Positioners

STANY favors expansion of exemptions to the Short Sale Rule for block positioners. The current rule, which allows block positioners to back out certain positions from its net position calculation, is much too cumbersome. We encourage the Commission to permit block positioners to sell short exempt when facilitating customer orders. Current New York Stock Exchange (NYSE) Rules (i.e. Rule 92 and Rule 97) that recognize block positioning demonstrate that an effective enforcement mechanism is in place to monitor the proper use of such an exemption. The NYSE has current surveillance that monitors "P" orders. An exemption for block trades would permit block positioners to provide their customers with higher quality executions. As the exemption would only be permitted to the extent that the short sale was done to facilitate a customer offer, the exemption would not lead to undeterred short selling.

Exemption of Short Sale Rule in After-Hours Trading

STANY advocates that any newly adopted short sale rule cease at the closing bell, in the same way as the current Nasdaq Short Sales Rule does. We believe that neither market professionals, nor the investing public, rely on the after-market prices as an accurate reflection of the market for a particular security. Therefore, the use of manipulative strategies based on after-market pricing seems unlikely. We are not aware of any Nasdaq case involving short sale manipulation that relied on after-hours trading as the basis of the manipulation. Moreover, aggressive naked short selling in illiquid securities in unlikely as the affirmative determination rule would be in effect. If however, the Commission believes that such an exemption is not warranted, we urge that the Short Sale Rule apply during times when the consolidated tape is not disseminated.

Unconditional Contracts to Purchase Securities

STANY believes that under a fair reading of Rule 3b-3, as it exists today, contracts to purchase securities would include, "stops at a fixed price", VWAP and MOC orders.[7] We believe that the current VWAP no-action letter is

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[4] See D. Timothy McCormick and Bram Zeigler, *The Nasdaq Short Sale Rule: Analysis of Market Quality Effects and The Market Maker Exemption, NASD Economic Research,* (August 7, 1997) at 22-23.

[5] The NASD's 1997 study indicates that during a sample month in 1997, market maker short sales at or below the inside bid accounted for only 2.41% of their total share volume. *Id.* at 27.

[6] Hearing Panel Decision as to Respondents John Fiero and Fiero Brothers, Inc. (December 6, 2000) (decision affirmed by the National Adjudicatory Council on October 28, 2002).

[7] Short Sale Proposal (Release No. 34-48709) states in part "In granting this conditional relief, we have noted that short sale transactions executed at the closing price generally do not represent the type of abusive practices that Rule 10a-1 is designed to prevent."

too unwieldy and restrictive.[8] A broker-dealer who guarantees an execution price should continue to be considered long the security under the definition on Rule 3b-3. STANY believes that any market manipulation concerns can be addressed through SEC Rule 10b-5 or prophylactic SRO guidance such as NYSE Information Memo 95-28.[9] As there are other regulatory tools in place to guard against and address manipulative trading, it is not necessary for SEC Rule 3b-3 to prophylacticly exclude parties to a contract from including securities unconditionally purchased as described above.

Many concerns will be addressed by adoption of Locate and Delivery Rules

Concerns about potential abusive trading and market manipulation through naked short selling will be extremely limited by the adoption of locate and delivery requirements. STANY believes that in addition, concerns that the Commission may have regarding bona fide market making activities can be addressed by SEC Rule 10b-5 and through the current interpretation of bona fide market making. [10]

STANY applauds the work of the SIA Operations Ad Hoc Committee (SIA Committee) and the NYSE toward a workable locate rule. It is our understanding that the SIA Committee is recommending the following:

1. There will be a national hard to borrow list, comprised of securities that meet the conditions of current NASD Rule 11830. That is at least a 10,000 share clearing fail and ½% or more of the total shares outstanding of the stock.

2. In order to comply with the locate rule for these securities, a firm must locate the security via its stock loan department or through a customer's prime broker. A firm cannot rely on the customer's affirmation or an easy to borrow list.

3. For any security not on the national list, a firm may, in the case of a DVP customer, rely on the customer's affirmation that they have borrowed the security. In the case of a client that clears at the firm, the firm can use an easy to borrow list.

4. The executing broker will indicate via electronic confirmation whether the sale was long or short. The prime broker will then be responsible to reconcile the executing broker's information to its own books and records. If there is a discrepancy, the prime broker must inform the executing broker.

The proposed locate Rule would properly focus on situations where less liquid securities become the subject of improper short selling activities. These activities are highly unlikely in actively traded securities.

Conclusion

STANY supports a uniform bid test for the Short Sale Rule across all markets. We request that the bid test be modeled upon the current Nasdaq bid test. The Nasdaq test has been proven effective and utilization of such a test will be cost efficient and time saving from a technological standpoint. We urge the Commission to retain and, in certain cases, expand upon market maker exemptions to the Short Sale Rule. The market maker exemption enhances price discovery, and enables market makers to provide superior execution to their customers. Elimination of the exemption will result in a decline in the willingness of market makers to commit capital and will decrease liquidity to the detriment of the individual and institutional investor. Lastly, and significantly, adoption of locate and deliver rules, as worked out between the SIA and the NYSE will not only guard against abusive naked short sales, but will eliminate naked short selling in the majority of cases.

STANY believes that there are already regulatory rules, as well as surveillance, in place that would safeguard the market. We ask that the Commission and SROs enforce rules that are currently in place to eliminate and guard against abuses rather than implement complicated short sale rules to regulate this area of trading. The Nasdaq bid test presently works. With stronger locate and delivery rules, the bulk of the concerns of the SEC should be

[8] See.Letter re: VWAP Trading System (March 24, 1999).
[9] See Footnote 97 of Short Sale Proposal (Release No. 34-48709) and text pointing out the availability of sophisticated surveillance mechanisms utilized by the SROs.
[10] See NASD Conduct Rule 3350 and IM-3350

adequately addressed. We agree with Commissioner Glassman that short selling serves a legitimate market function and that for the most part, restrictions on short selling are unnecessary.

STANY, and its Officers and Directors, stand ready to discuss the issues raised in this letter with the Commissioners and would be happy to provide any additional input the Commissioners may require.

Respectfully submitted,

Lisa A. Utasi President	Gary Distell Director Board Liaison STANY Trading Issues Committee	Kimberly Unger Executive Director