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February 12, 2007

Via Electronic Mail (rule-comments@sec.gov)

Nancy M. Morris

Secretary

Office of the Secretary

U.S. Securities and Exchange Commission

100 F Street, N.E.

Washington, D.C. 20549

Re: File Number S7-21-06

Dear Ms. Morris:

The Security Trader's Association ("STA") welcomes the opportunity to comment on the Commission's proposal to remove the tick test of Rule 10a-1, add Rule 201 of Regulation SHO to provide that no price test, including any price test of any SRO, shall apply to short sales in any security, prohibit any SRO from having a price test, and amend Rule 200(g) of Regulation SHO to remove the requirement that a broker-dealer mark a sell order of an equity security as "short exempt" if the seller is relying on an exception from the price test of Rule 10a-1, or any price test of any exchange or national securities association.¹

The STA is a worldwide professional trade organization that works to improve the ethics, business standards and working environment for our members. There are approximately 5,200 members, all engaged in the buying, selling, and trading of securities. Members participate in STA through 27 national and international affiliate organizations and represent the interests of the trading community and institutional investors. The STA provides a forum for our traders, representing institutions, broker-dealers, ECNs, and floor brokers to share their unique perspectives on issues facing the securities markets. They work together to promote their shared interest in efficient, liquid markets as well as in investor protection.

¹ Securities Exchange Act Release No. 54891 (December 6, 2006); 71 FR 75068 (December 13, 2006)

Alabama Security Dealers Association
Boston Security Traders Association
Canadian Security Traders Association
Carolina Security Traders Association
Security Traders Association of Chicago
Cleveland Security Traders Association
Security Traders Association of Connecticut
Dallas Security Traders Association

Denver Security Traders Association
Security Traders Association of Florida
Association Française des Equity Dealers
Georgia Securities Association
Kansas City Securities Association
London Security Traders Association
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Security Traders Association of St. Louis
Institutional Equity Traders Association of
Toronto
Vancouver Security Traders Association
Security Traders Association of Wisconsin

Dictum Meum Pactum

The STA commends the Commission for conducting a thorough analysis of short sale activity, during the Pilot Period established by the implementation of Regulation SHO, with and without the application of price test restrictions that was based on empirical data, input and study from regulators, industry representatives, academia and the public. Moreover, the Commission's proposal is consistent with the STA's previously submitted comments to proposed Regulation SHO² and issues addressed in the STA's White Paper³. As is described in greater detail below, with a few caveats, the STA fully supports the Commission's proposal to remove the tick test of Rule 10a-1, add Rule 201 of Regulation SHO to provide that no price test, including any price test of any SRO, shall apply to short sales in any security, prohibit any SRO from having a price test and amending Rule 200(g) of Regulation SHO to remove the requirement that a broker-dealer mark a sell order of an equity security as "short exempt" if the seller is relying on an exception from a short sale price test restriction.

The Elimination of Short Sale Price Test Restrictions and Prohibiting any SRO from Having a Price Test Restriction is Consistent with and Responsive to the STA's Previous Statements and Comments Regarding its Concerns About Regulatory Arbitrage.

In its Regulation SHO Comments, the STA, understanding that there would be continuing short sale regulation while the pilot program was in effect, fully supported the SEC's efforts to establish a uniform pricing test applicable to all covered equity securities during the Pilot Period. Relying on its White Paper, the STA stated that "regulatory arbitrage serves to reduce the overall quality of our markets and must be eliminated." And "that the SEC must mandate the adoption of consistent, standardized trading rules, such as the short sale rule, among markets trading like classes of securities (i.e. NASDAQ securities and exchange-listed securities)."⁴

The Commission, however, did not establish a uniform pricing test and, thus, as stated in the Commission's proposal "current short sale regulation is disparate with different price tests applying depending on the type of security being sold and where the short sale order is executed. . . This disparate regulation has the potential for confusion and compliance difficulties. In addition, we are concerned that this current market structure could competitively disadvantage investors because short sale orders obtain different treatment depending on where the orders are executed."⁵

The STA has long argued that any aspect of regulatory arbitrage should be resolved and eliminated and fully supports the Commission's efforts in this area. Elimination of price test restrictions and prohibiting SROs from implementing the same will eliminate regulatory arbitrage in short sale regulation and will allow marketplaces to compete with each other on the basis of execution quality, not regulatory disparities. This should increase public investor confidence in the markets.

Elimination of Short Sale Price Test Restrictions is Consistent with Past STA Comments Regarding the Necessity of Such Regulation.

² Letter from Security Trader's Association (January 9, 2004), <http://www.securitytraders.org/2.PDF>. (hereinafter "Regulation SHO Comments").⁴

³ Security Traders Association, *Special Report; Fulfilling the Promise of the National Market System. STA's Perspective on U.S. Market Structure* (August 2003). (hereinafter "STA White Paper").

⁴ STA White Paper at p. 7.

⁵ 71 FR at 75075



The STA understands that short sale price restrictions are largely supported and promoted by issuers who are legitimately concerned about maintaining the price level of their stock. However, at the same time it is equally important that public investors be allowed to identify “overvalued” securities and trade pursuant to that legal investment strategy. Moreover, short selling overvalued securities is a legal and acceptable trading strategy employed by investors that may not only result in a profit but may also result in an ultimate price in the security that is more reflective of the financial condition of the issuer and a more accurate representation of the natural forces of supply and demand.⁶ We believe that the Commission’s analysis has demonstrated that if short sale price restrictions are eliminated, the interests of issuers will be protected while at the same time best execution of public customer orders will be enhanced and the markets will operate more efficiently.

Additionally, the Commission’s analysis of the current state of short sale regulation reveals a number of exceptions and exemptions of the rule previously granted by the Commission to protect the best execution of customer orders. We agree with the Commission that these numerous exceptions and exemptions potentially create an unlevel playing field among market participants and that the price restriction tests have failed to keep pace with new trading strategies and systems.⁷

Further, in its Regulation SHO Comments, the STA asked the Commission to determine whether a rule designed solely to artificially shield the price of a security from the natural forces of supply and demand and legitimate investment activity is necessary or desirable in today’s marketplace.⁸ The Commission’s analysis of the empirical data regarding trading with and without short sale price restrictions and industry and academia studies of the same have demonstrated that short sale price test restrictions are unnecessary. The analyses also shows that elimination of the short sale price test restriction tests would not have any significant effect on volatility and liquidity of most securities currently the subject of such rules.⁹ As a result, consistent with our previous comments and statements and the findings of the Commission, we fully support its proposal to eliminate and prohibit any short sale price test restrictions.

Consistent and Robust Surveillance and Enforcement of Other Short Sale and Trading Rules is Necessary to Protect Issuers and the Marketplace

Short sale price restrictions were initially enacted to prevent short selling in a declining market and inhibit “bear raid” and “short squeeze” type manipulations. Today, the marketplace is much more transparent and subject to highly sophisticated and almost real time surveillance. In addition, manipulative trading activity, like that described above, is prohibited by the general anti-fraud and anti-manipulation federal security laws and rules and the rules of the SROs. As previously stated, there are no rules which specifically address trading in a rising market, but regulators successfully employ surveillance and examination techniques that identify manipulative activity in that type of market. These same techniques applied in falling markets should likewise identify manipulative and fraudulent activity in a falling market. The Commission and the SROs need to continue their efforts to detect manipulative activity and respond with enforcement activity.

⁶ Regulation SHO Comments at p. 3.

⁷ 71 FR at 75075.

⁸ Regulation SHO Comments at p. 3.

⁹ Some analyses revealed small undesirable effects on liquidity and volatility in smaller capitalized securities. We believe it critically important for the SEC to continue monitor the effects of the elimination short sale price restrictions on these and other securities to ensure that there are no unintended or surprising effects on the markets as a result of this action.

Moreover, the locate rules of Regulation SHO, if properly enforced, make it harder to borrow less liquid smaller capitalized securities (those more likely to be subject to manipulative activity) and make it more difficult to engage in a manipulation. Particularly in light of the elimination of short sale price test restrictions, the STA believes it critical that the Commission and the SROs should continue to actively and significantly enforce Regulation SHO's requirements through surveillance, examination and investigative techniques.

The SEC's Proposed Elimination of Short Sale Price Restrictions Should be Imposed Prior to July 9, 2007, the "Pilot Stocks Phase Date" of the Implementation of Regulation NMS.

The STA believes that the SEC's proposal to eliminate Short Sale Price Restrictions must be imposed prior to the requirement of industry compliance with Regulation NMS Rules 610 and 611 to specific securities. Specifically, the industry has been undertaking massive technology and compliance projects involving significant manpower and resources to ensure compliance with Regulation NMS. To date, this complex and sophisticated programming has progressed with the assumption that short sale price restrictions would be resident in certain markets. If the SEC's proposal is implemented subsequent to the operation of Regulation NMS to certain securities, it will require industry-wide re-programming of Regulation NMS compliant systems during the infancy of the Rules implementation, a most sensitive period of time. As a result, the immediate success of Regulation NMS could be compromised. Moreover, there remains certain open questions regarding simultaneous compliance with short sale price restrictions and Regulation NMS that have not been resolved. Elimination of price restrictions prior to Regulation NMS would render those issues moot.

If the SEC determines to impose the elimination of short sale price restrictions after Regulation NMS implementation to certain securities, the STA respectfully requests that the SEC provide no-action relief for industry participants from enforcement for violations of any SEC or SRO short sale price restriction during that period.

While the STA Supports Removing the "Short Exempt" Order Marking, Other Order Marking Issues Must Also be Addressed.

Currently, SEC Rule 203(b)(2)(ii) provides that the locate rule not apply when a broker-dealer has been reasonably informed that the customer intends to deliver the security as soon as all restrictions on delivery have been removed. As this was also an exception from short sale price restrictions, such orders were to be marked and reported "short exempt." Once the short exempt marking requirement is eliminated, how should such orders be marked and reported? Marking such orders "short" does not accurately describe the customer's ownership of the same and could cause confusion and anger from public investors when they receive confirmation of the sale of a security they understood they owned. As a result, the STA believes that the definition of long sale be amended to include delayed delivery sales, simultaneously with the elimination of the "short exempt" marking requirement.

Commission's Specific Requests for Comment

- *The proposed amendments state that no "short sale price test" shall apply to short sales in any security. Should we define the term "short sale price test" for purposes of these amendments?*

We believe defining the term "short sale price test" is unnecessary and may make it easier for an SRO to implement similar restrictions without technically violating the specific terms of a definition. If there is no definition of the term, whether or not a proposed restriction operates in violation of the Commission's proposal would be subject to Commission analysis and public comment. We believe that process would ferret out proposals that operate as a "short sales price test."

• Some SROs have adopted price tests to attract issuers concerned about the potential effects of short selling on the issuer's stock price. The proposed amendments would prohibit any SRO from having its own price test. If the Commission removes Rule 10a-1, should the Commission continue to allow the SROs to adopt their own price tests? Should the Commission require uniformity with respect to any SRO price tests? Should any such SRO price tests be limited to certain securities? What would be the costs and benefits of allowing the SROs to adopt their own price tests?

By reason of our foregoing discussion, the STA believes that elimination of price tests will enhance the markets and customer executions. Moreover, it will eliminate the regulatory arbitrage that has been present in the application of such rules.

• To what extent does the tick test of Rule 10a-1 impose market costs on traders desiring to sell short? For example, if the removal of price test restrictions were to result in wider spreads, could this result in higher transaction costs for all traders? What would be the impact on investors? Would the removal of the price test restrictions result in shifting higher trading costs from short sellers to other traders? To what extent would such costs justify any benefits of removing price test restrictions?

We do not believe the removal of short sale price restrictions will result in higher trading costs or wider spreads. The pilot data seems to confirm this. We also believe there will be a reduction in surveillance and compliance costs.

• To what extent does the tick test of Rule 10a-1 affect the ability to sell short in a decimals environment? Please explain any difficulties of complying with the tick test or any other price test in a decimals environment. In light of all the exemptions from, and exceptions to, Rule 10a-1, how significant a test is it? On what types of trading activities does Rule 10a-1 have a significant or meaningful impact? Similarly, in light of the exceptions to NASD Rule 5100 and Nasdaq Rule 3350, how significant are these tests? On what types of trading activities do NASD Rule 5100 and Nasdaq Rule 3350 have a significant or meaningful impact? Please explain.

The test is significant in a decimals environment due to the fact that a one penny downturn can prevent the timely execution of a customer transaction. Moreover, the frequency of quotation changes increases the difficulty of individual traders and systems to recognize when a legal short sale can be executed.

• To what extent, if any, is retention of price test restrictions valuable for investor confidence to commit capital to the markets?

Market transparency and regulatory surveillance of market activities combined with active, swift and meaningful enforcement of Regulation SHO and the general anti-fraud and anti-manipulation rules makes price test restrictions an insignificant factor in establishing investor confidence in the market place.

• Is the tick test in Rule 10a-1 appropriate for some securities but not all securities? If the Commission were to maintain a price test for some securities, which types of securities should be subject to a price test?

As discussed above, we believe this type of regulatory arbitrage should be eliminated. That being said, the Commission needs to monitor the operations of the markets subsequent to the elimination of price test restrictions to ensure that there are no unexpected consequences.

- *We note that in 2003, in the Regulation SHO Proposing Release, we proposed adopting a price test using the consolidated best bid as a reference point for permissible short sales. Should the Commission adopt a new price test, such as a uniform bid test, that would replace all current price tests, including those of any exchange or national securities association? If so, should the new price test apply to all securities, including those not currently subject to a price test? What should be the requirements of any new price test?*

For all of the reasons discussed above, the STA believes that the Commission's proposal to remove the tick test of Rule 10a-1, provide that no price test, including any price test of any SRO, shall apply to short sales in any security and prohibit any SRO from having a price test should be adopted.

- *If the Commission were to maintain the tick test contained in Rule 10a-1, should the Commission amend the tick test to apply to all markets or securities equally?*

For all of the reasons discussed above, the STA believes that the Commission's proposal to remove the tick test of Rule 10a-1, provide that no price test, including any price test of any SRO, shall apply to short sales in any security and prohibit any SRO from having a price test should be adopted.

- *If the Commission were to maintain the tick test contained in Rule 10a-1, which, if any, of the exceptions contained in paragraph (e) of Rule 10a-1 should the Commission retain? Please explain. Should the Commission include exceptions not currently in Rule 10a-1? What should those exceptions address?*

For all of the reasons discussed above, the STA believes that the Commission's proposal to remove the tick test of Rule 10a-1, provide that no price test, including any price test of any SRO, shall apply to short sales in any security and prohibit any SRO from having a price test should be adopted.

- *If the Commission were to retain the tick test contained in Rule 10a-1, should the Commission codify all the exemptions the Commission has previously granted from this rule? If not all the exemptions, which exemptions should the Commission codify?*

For all of the reasons discussed above, the STA believes that the Commission's proposal to remove the tick test of Rule 10a-1, provide that no price test, including any price test of any SRO, shall apply to short sales in any security and prohibit any SRO from having a price test should be adopted.

- *NASD Rule 5100 and Nasdaq Rule 3350 contain exceptions for bona-fide market making. If the Commission were to retain the tick test contained in Rule 10a-1 or adopt a new price test, should such price test include an exception for bona-fide market making? If the Commission were to continue to allow for a market maker exception in NASD Rule 5100 or Nasdaq Rule 3350 or adopt a price test that contains a market maker exception, should the Commission limit the applicability of the exception? How should it be limited? What would be the purpose of such limitations?*

For all of the reasons discussed above, the STA believes that the Commission's proposal to remove the tick test of Rule 10a-1, provide that no price test, including any price test of any SRO, shall apply to short sales in any security and prohibit any SRO from having a price test should be adopted.

- *We request specific comment regarding the importance of retaining a market maker exception, for example, with respect to liquidity, price efficiency, market depth, speed of execution and flexibility for capital commitment. • Should the Commission retain a price test for times during which there are unusual market declines? If so, please discuss what type of price test should be retained and under what types of circumstances such a price test should be applied?*

For all of the reasons discussed above, the STA believes that the Commission's proposal to remove the tick test of Rule 10a-1, provide that no price test, including any price test of any SRO, shall apply to short sales in any security and prohibit any SRO from having a price test should be adopted.

• If the Commission were to maintain the current tick test of Rule 10a-1 or adopt a new price test, should the price test apply only during regular market hours or should the price test apply regardless of when trades occur? What are the benefits and costs of applying price tests in the after-hours market?

For all of the reasons discussed above, the STA believes that the Commission's proposal to remove the tick test of Rule 10a-1, provide that no price test, including any price test of any SRO, shall apply to short sales in any security and prohibit any SRO from having a price test should be adopted.

• Would removal of all price test restrictions result in the markets being truly representative of what is a fair price for an individual security?

The removal of all price test restrictions would allow the market price of securities to be determined by the free forces of supply and demand without any artificial restraints on the securities trading.

• Are there any technical or operational challenges that would arise in complying with the proposal if the Commission were to adopt the proposal?

The STA believes that the elimination of price test restrictions would not give rise to any technical or operational challenges. The industry would need some time, however, to reprogram its trading systems.

• How much would the proposed amendments affect specific compliance costs or other costs for small, medium and large entities (brokers, dealers, and SROs)?

Since firms would no longer be required to monitor compliance with price test restrictions, compliance costs would be reduced.

• Should we provide a compliance date, separate from an effective date, if the Commission were to adopt the proposed amendments? If yes, please explain why a compliance date would be appropriate and give suggestions as to how long a compliance period would be needed.

See discussion above. The SEC believes effectiveness and compliance should occur prior to July 9, 2007.

• If the Commission were to adopt the proposed amendments, the Commission and the SROs would continue to monitor for manipulative activity. Should the Commission ask the SROs to submit periodic reports regarding the effects of the removal of price tests at regular intervals, for example, on a semi-annual or annual basis? What would be the costs associated with such reporting?

As stated above we believe that both the Commission and the SROs should continue to monitor the markets to determine if there are any unexpected results or consequences as a result of the elimination of price test restrictions.

B. Removal of “Short Exempt” Marking Requirement

• *If the Commission were to adopt the proposal to remove the “short exempt” marking requirement of Rule 200(g) of Regulation SHO, would it be sufficient to require broker-dealers to mark all sell orders of any equity security as either “long” or “short”? Under what circumstances, if any, would broker-dealers need to mark sell orders other than as “short” or “long”?*

As briefly stated above, the STA supports the proposal to eliminate the requirement to mark and report orders short exempt. We believe, however, that issues must be addressed regarding certain situations where orders are currently marked short exempt but for which the current proposal does not discuss how such will be marked and reported subsequent to the elimination of the short exempt marking requirement.

Currently, SEC Rule 10a-1, NASD Rule 5100, NASDAQ Rule 3350 and SEC Rule 203(b)(2)(ii) (Regulation SHO locate rule) except “delayed delivery” transactions from short sale price restriction tests and the locate rule. Specifically, this is a situation where a broker-dealer has been reasonably informed that the customer intends to deliver the security as soon as all restrictions on delivery have been removed. An example of this type of transaction is where the delivery of once restricted securities under Rule 144 is delayed by the mechanics of removing the restricted legend from those securities.

We believe that it would not make sense to retain the “short exempt” marking requirement for this limited scenario and, moreover, identifying such a transaction as “short exempt” or “short” is misleading and potentially confusing to the customer, the investing public and industry participants. After all, the customer selling this security “owns” it and does not have any belief that he has effected a short sale.

As a result, we believe that the definition of “long” sale should be amended to provide that a long sale will include:

Any sale of a security that a person is deemed to own pursuant to §242.200, provided that the broker or dealer has been reasonably informed that the person intends to deliver such security as soon as all restrictions on delivery have been removed. If the person has not delivered such security within 35 days after the trade date, the broker-dealer that effected the sale must borrow securities or close out the short position by purchasing securities of like kind and quantity.

We believe that defining these transactions as long sales will allow the complete elimination of the “short exempt” market requirement, ease systems, compliance and regulatory costs and provide more accurate and useful information to the marketplace. As a result, the STA believes that the definition of long sale be amended to include delayed delivery sales, simultaneously with the elimination of the “short exempt” marking requirement.

Conclusion

The STA supports the Commission's proposal to remove the tick test of Rule 10a-1, add Rule 201 of Regulation SHO to provide that no price test, including any price test of any SRO, shall apply to short sales in any security, prohibit any SRO from having a price test and amending Rule 200(g) of Regulation SHO to remove the requirement that a broker-dealer mark a sell order of an equity security as "short exempt" if the seller is relying on an exception from a short sale price test restriction. If we can provide further clarification or further information on this proposal, please do not hesitate to contact us at (212) 867-7002.

Very truly yours,



Lisa M. Utasi
Chairman of the Board



John C. Giese
President and CEO

cc: The Honorable Christopher Cox, Chairman
The Honorable Paul S. Atkins, Commissioner
The Honorable Roel C. Campos, Commissioner
The Honorable Annette L. Nazareth, Commissioner
The Honorable Kathleen L. Casey, Commissioner
Erik R. Sirri, Director, Division of Market Regulation, SEC
Robert L.D. Colby, Deputy Director, Division of Market Regulation, SEC
Brian Cartwright, General Counsel, Office of General Counsel, SEC