



## MANAGED FUNDS ASSOCIATION

February 12, 2007

VIA ELECTRONIC MAIL: [rule-comments@sec.gov](mailto:rule-comments@sec.gov)

Securities and Exchange Commission  
100 F Street, N.E.  
Washington, D.C. 20549

Attention: Nancy M. Morris, Secretary

**Re: Proposed Amendments to Regulation SHO and Rule 10a-1; File No. S7-21-06**

Ladies and Gentlemen:

In response to the request of the Securities and Exchange Commission (the “Commission”), Managed Funds Association (“MFA”) offers the following comments on Securities Exchange Act Release No. 54891 (Dec. 7, 2006) (the “Release”), “Amendments to Regulation SHO and Rule 10a-1.”<sup>1</sup> We appreciate the opportunity for all segments of the trading and investing community to offer their views on proposed Commission actions, and we hope that our comments prove helpful to the Commission. As discussed below, we fully support the Commission’s proposal to remove restrictions on the execution prices of short sales (“price tests” or “price test restrictions”) and to prohibit any self-regulatory organization (“SRO”) from having a price test.

Managed Funds Association (“MFA”) is the only U.S.-based global membership organization dedicated to serving the needs of those professionals throughout the world who specialize in the alternative investment industry, including hedge funds, commodity pool operators, funds of funds and managed futures funds. MFA’s over 1,200 members include professionals from the majority of the 50 largest hedge funds, which manage a significant portion of the estimated \$1.3 trillion in assets under management currently invested with hedge funds.

### **Introduction**

MFA applauds the Commission for its efforts towards removing obsolete and unnecessary regulations. The Commission and its staff, through the Regulation SHO Rule 202T one-year pilot test (“Pilot”) to the proposed Amendments to Regulation SHO and Rule 10a-1, have embodied securities rulemaking at its finest. MFA is proud to support rule proposals based on such sound economic research and justification. The

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<sup>1</sup> 71 FR 75067.

Commission's Office of Economic Analysis ("OEA") has played a significant and commendable role in analyzing and evaluating data from the Pilot as part of the Commission's rulemaking process.<sup>2</sup> Equally laudable has been the public service that OEA and the division of Market Regulation have performed in carefully analyzing the impact of the price restriction tests and proposing appropriate rules in light of the evidence indicating little empirical justification for maintaining price tests.

MFA regards short selling as an essential method by which investors, including fiduciaries managing others' assets, can manage risk, hedge their portfolios, and reflect their view that the current market price of a security is higher than it should be. The benefits of short selling to the broader market are well known,<sup>3</sup> and recognized by the Commission. Short selling provides liquidity to the market and makes markets more efficient.

Market developments such as technological innovations and decimalization have transformed the trading landscape from when Rule 10a-1 was first adopted and changed the impact of price test restrictions. The evidence is clear that the relatively liquid securities studied in the Pilot were not affected by price tests. On the other hand, small and more thinly-traded securities, such as NASDAQ Capital Market, OTCBB and Pink Sheets securities, have never been subject to price test restrictions. NASDAQ securities traded on other exchanges also are not subject to any price tests. These securities have thrived without price test restrictions, and we are not aware, nor has the Commission presented any information in the Release suggesting, that they have experienced a disproportionate share of manipulative short selling. The OEA Staff's Draft Summary Pilot Report concludes that: "price restrictions constitute an economically relevant constraint on short selling;" and there is no indication that there is an association between manipulative short selling, such as "bear raids," and price test restrictions on short selling.<sup>4</sup> The evidence indicates that price test restrictions are no longer relevant in today's trading environment.

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<sup>2</sup> See Office of Economic Analysis U.S. Securities and Exchange Commission, [Economic Analysis of the Short Sale Price Restrictions Under the Regulation SHO Pilot](http://www.sec.gov/about/economic/shopilot091506/draft_reg_sho_pilot_report.pdf) (September 14, 2006) (the "OEA Staff's Draft Summary Pilot Report"), available at [http://www.sec.gov/about/economic/shopilot091506/draft\\_reg\\_sho\\_pilot\\_report.pdf](http://www.sec.gov/about/economic/shopilot091506/draft_reg_sho_pilot_report.pdf).

<sup>3</sup> See, e.g., Arturo Bris, William N. Goetzmann and Ning Zhu, "Efficiency and the Bear: Short Sales and Markets Around the World" (Yale School of Management, Jan. 2003), a study of forty-seven stock markets around the world, in which the authors found that markets with active short sellers reacted to information more quickly and set prices more accurately; and Owen A. Lamont, "Go Down Fighting: Short Sellers vs. Firms", available at <http://www.som.yale.edu/faculty/oa14/research/go%20down%20fighting.pdf> (concluding that constraints on short selling as a result of various actions taken by firms allow stocks to be overpriced and that firms taking antishorting actions have in subsequent year abnormally low returns of about minus two percent per month).

<sup>4</sup> OEA Staff's Draft Summary Pilot Report, at p. 56.

In light of the Pilot evidence, we feel strongly that current price test restrictions impose unnecessary costs on market participants in terms of time and technology. We strongly agree with the Commission's conclusion that disparate short sale regulation leads to confusion and added complexity in compliance by market participants, and may competitively disadvantage certain investors depending on the market center on which their order is executed. We also believe that the increased incidence of no-action relief granted from Rule 10a-1 potentially creates an un-level playing field among market participants.

We feel that price tests are outdated in today's market environment and support simplified and uniform market regulations to the greatest extent possible. Thus, we strongly support the Commission's proposal to remove the tick test of Rule 10a-1 and add Rule 201 of Regulation SHO to provide that no price test, including any price test of any SRO, should apply to short sales in any security.

### **Comments to Amendments to Rule 10a-1 and Rule 201**

Price test restrictions. The Release asks whether price test restrictions should apply to securities not currently covered by any price test restrictions, whether price test restrictions are more appropriate for certain securities, and whether SROs should be allowed to have their own price tests. MFA feels strongly that in the interests of fairness and lower trading costs for investors and simplicity and efficiency for market participants, U.S. markets should have uniform regulations that do not permit price test restrictions. Small or thinly-traded securities should be treated no differently, especially in light of the Pilot results which suggest that price restrictions affect thinly-traded securities no differently than actively-traded securities.<sup>5</sup> Equally noteworthy is that the Pilot data showed no indication of an association between manipulative short selling, such as "bear raids," and price test restrictions on short selling.<sup>6</sup> Without compelling evidence that more thinly-traded securities are disproportionately handicapped by manipulative short-selling and that price test restrictions would curb manipulative short-selling, we do not believe there is any justification for imposing price test restrictions on thinly-traded securities or securities traded on individual exchanges or markets.

Information on short selling transactions. The Release asks whether markets should continue making transactional short selling data public. We believe that transactional short selling information is helpful to the Commission and to overall market

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To the extent that manipulative short selling is a concern, we believe and agree with the Commission that today's high levels of transparency and sophisticated surveillance allow manipulative or abusive short selling activity to be detected more readily and pursued in the absence of price restrictions.

<sup>5</sup> 71 FR 75076.

<sup>6</sup> See OEA Staff's Draft Summary Pilot Report *supra* n. 2.

efficacy in monitoring for potential short selling abuses. We believe, however, that such information should only be readily available to law enforcement authorities. As discussed, we believe short selling plays a vital role in the efficiency of markets. We are concerned that public transactional short selling data may fuel frivolous issuer lawsuits against market participants with a legitimate but different view of the value of an issuer's securities. We want to preserve the integrity of the U.S. markets by ensuring that enforcement authorities have the appropriate tools and information for ferreting out manipulative trading, but that innocent market participants are not threatened or intimidated from pursuing legitimate trades that reflect their judgment of the market price.

### **Comments on Amendment to Rule 200(g) of Regulation SHO**

“Short exempt” marking requirement. The Release asks whether the “short exempt” marking will be necessary if there are no price test restrictions. MFA believes that the “short exempt” marking requirement would no longer be applicable and supports the Commission's proposal to remove this marking requirement. We recognize, however, that broker-dealers are in the best position to raise compliance issues related to their systems and the “short-exempt” marking requirement. Therefore, we urge the Commission to carefully consider any compliance concerns raised by broker-dealers in considering this proposal.

Disclosure of order type. The Release asks whether market makers and specialists have an advantage over other market participants since they are able to distinguish short sales from other sales. In protecting the confidentiality of customer orders and maintaining a level playing field for all market participants, MFA supports the idea of availing order marking information only to brokers preparing order tickets. We believe the best safeguard for maintaining the integrity of order information is by limiting order marking information to those necessary in carrying out compliance functions. To the extent that it is practical for brokers to develop systems to suppress order marking information, we support limiting such information only to brokers preparing order tickets.

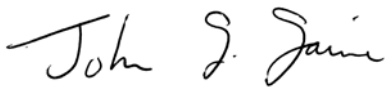
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## Conclusion

MFA appreciates the opportunity to provide its views on the proposals and questions that the Commission has promulgated. We would welcome an opportunity to meet with the Commissioners and the Staff if it would provide assistance in your deliberations on these issues.

Respectfully submitted,



John G. Gainé  
President

Cc: The Hon. Christopher Cox, Chairman  
The Hon. Paul S. Atkins Commissioner  
The Hon. Roel C. Campos  
The Hon. Annette L. Nazareth  
The Hon. Kathleen L. Casey  
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