February 16, 2007

Ms. Nancy M. Morris
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-9303

Re: Release No. 34-54891; File Number S7-21-06
Amendments to Regulation SHO and Rule 10a-1

Ms. Morris:

The Securities Industry and Financial Markets Association ("SIFMA")[1] appreciates the opportunity to comment on the Securities and Exchange Commission's (the "SEC" or "Commission") proposed amendments to Rule 10a-1, under the Securities Exchange Act of 1934, as amended ("Rule 10a-1" or the "Rule"). Specifically, the Commission is proposing to: (i) eliminate the "tick test" of Rule 10a-1, as well as the "price test" of any national securities exchange or national securities association *(e.g.*, the NASD "bid test"); (ii) prohibit any self-regulatory organization ("SRO") from enacting any future "price test" on short sales; and (iii) amend Rule 200(g) of Regulation SHO to remove the requirement that broker-dealers mark sales "short exempt." The Commission also raised in the Rule 10a-1 Proposing Release ("Proposing Release")[2] a number of other questions concerning the operation of the Rule, including whether to institute an alternative price test, such as a uniform bid test. It is our understanding that the Commission would not be intending to adopt new modifications to Rule 10a-1 relating to the issues raised in these questions at this time, but would rather, to the extent it decides not to eliminate the price test, propose such amendments for comment in a separate

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[1] The Securities Industry and Financial Markets Association brings together the shared interests of more than 650 securities firms, banks and asset managers. SIFMA's mission is to promote policies and practices that work to expand and perfect markets, foster the development of new products and services and create efficiencies for member firms, while preserving and enhancing the public's trust and confidence in the markets and the industry. SIFMA works to represent its members' interests locally and globally. It has offices in New York, Washington D.C., and London and its associated firm, the Asia Securities Industry and Financial Markets Association, is based in Hong Kong.

[2] Securities Exchange Act Release No. 54891 (December 6, 2006), 71 FR 75068 (December 13, 2006).

rulemaking proceeding. SIFMA appreciates the opportunity to comment further on any such specific proposals at the appropriate time.

I. Introduction

SIFMA echoes the Commission's statements at the Open Meeting announcing these amendments, in which it commended the SEC Staff for their actions culminating in these proposed amendments. In particular, SIFMA notes that the SEC Staff engaged in a comprehensive process of: (i) selecting a sample of securities to be included in the Regulation SHO Pilot (the "Pilot"); (ii) analyzing data derived from such Pilot in order to determine the potential impacts associated with removing a price test; (iii) presenting its analysis in a public document; and (iv) hosting a Regulation SHO Roundtable to facilitate further discussion and analysis of the Pilot. SIFMA believes that such a careful and thoughtful process should be employed as a model for future Commission rulemaking.

As outlined in further detail below, and as supported by the analysis of the Pilot data by the Commission's Office of Economic Analysis ("OEA"), SIFMA believes that short sale price tests impose unnecessary costs and frictions in today's markets, and thus fully supports the Commission eliminating the Rule 10a-1 tick test and prohibiting any SRO from maintaining or establishing a price test.

II. Analysis of Pilot data supports elimination of price tests

The Reg SHO Pilot was intended to examine the effectiveness of short sale price test restrictions. The Pilot went into effect on May 2, 2005 and currently is due to expire on August 6, 2007. Under the Pilot, a third of the stocks in the Russell 3000 Index have been exempted from all price test restrictions. The exempted stocks constitute a sample of the Russell 3000 Index stratified across average daily trading volume levels within each of three groups, corresponding to the issues listed on the New York Stock Exchange, NASDAQ and the American Stock Exchange.

OEA collected data from the Pilot, analyzed such data, and issued a draft report providing its results. Data from the Pilot was also provided publicly, in order to allow others to examine the data and perform their own analysis. After comparing trading activity in the exempted stocks against stocks not included in the Pilot, OEA concluded that price test restrictions constitute "an economically relevant constraint on short selling," which thereby may induce some traders to avoid short selling or reduce the size of their short positions. OEA indicated that removing price restrictions had an effect on the mechanics of short selling, order routing decisions, displayed depth, and intraday volatility.

On balance, the Pilot results provide little evidence suggesting that the removal of price test restrictions would encourage market volatility, or harm price efficiency or liquidity. Indeed, as noted by the Commission in the Proposing Release, the

OEA report suggests that price test restrictions may in fact have a larger *negative* than *positive* impact on the markets, noting in particular that: (i) price test restrictions result in decreased short selling volume, thus depriving the marketplace of important benefits such as liquidity and price efficiency; and (ii) price test restrictions result in market participants routing orders to market centers that do not have price tests, thereby resulting in a loss of trading volume for market centers that in fact have a price test, as well as encouraging regulatory arbitrage.[3]

Perhaps most importantly, the Pilot data does not indicate any association between manipulative short selling, such as "bear raids," and price test restrictions.[4] Furthermore, as the Commission has noted, current market surveillance should be able to detect manipulative short selling schemes, and allow for disciplinary action under the general anti-fraud and anti-manipulation rules. The empirical analyses of the Pilot not only provide support for removing price test restrictions for large or actively-traded securities, but also do not provide support for extending price test restrictions to small or thinly-traded securities. In summary, OEA found little empirical justification for maintaining price test restrictions.

III. Numerous requests for exemptive relief demonstrate that the price test does not fit today's markets

As noted by the Commission in the Proposing Release, there have recently been numerous requests for exemptive relief from the Rule 10a-1 tick test, thus suggesting that the rule has not kept pace with current developments in the markets and also imposes restrictions that are burdensome and/or not necessary to achieve the Rule's stated goals.[5] This has become especially apparent with the Commission's adoption of Regulation NMS ("Reg NMS"). Notably, SIFMA and its member firms have been engaged in numerous discussions with the Commission Staff regarding requests for exemptive relief from the tick test in order to accommodate changes in trading activities brought about by Reg NMS. These include requests for relief for: (i) short sales by broker-dealers to facilitate customer orders at a "stopped price," in a manner consistent with an exception provided from the Order Protection Rule; (ii) short sales by broker-dealers to facilitate customer orders at "benchmark prices," such as a security's intra-day volume weighted average price ("VWAP"), also in a manner consistent with an exception from the Order Protection Rule; and (iii) pricing adjustments and error trades.

SIFMA strongly urges the Commission to take action to eliminate price test restrictions prior to the implementation of Reg NMS. Specifically, SIFMA notes that the Commission has recently extended the Reg NMS implementation dates as follows:

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[3] 71 FR at 75075.

[4] *Id.* (noting that the OEA Staff's Draft Summary Pilot Report did not evidence an increase in manipulative short selling during the time period studied).

[5] 71 FR at 75071-75072.

(i) the Commission has extended until March 5, 2007 the Trading Phase Date (final date for full operation of Reg NMS-compliant trading systems of all automated trading centers that intend to qualify their quotations for trade-through protection under Rule 611); (ii) the Commission has extended until July 9, 2007 the Pilot Stocks Phase Date (start of full industry compliance with Rule 610 and Rule 611 for 250 NMS stocks); and (iii) the Commission has extended until October 8, 2007 the Completion Date (start of full industry compliance with Rule 610 and Rule 611 for all remaining NMS stocks).[6]

SIFMA would strongly urge the Commission to take steps to eliminate short sale price tests prior to the Pilot Stocks Phase Date in order to alleviate the necessity for member firms to, in the course of instituting programming changes to meet the new requirements of Reg NMS, program systems to comply with a short sale price test, only to be required to reverse such programming changes *(i.e.*, to remove price test restrictions) shortly thereafter. Cost estimates from firms to program for such changes varied, from as low as approximately $200,000 for some firms to as high as $2 million for others. It would clearly not be equitable to require firms to incur programming costs for such a short period of time, especially in light of the Commission's empirical analyses indicating that price tests are simply not necessary to guard against potentially manipulative trading strategies. To the extent that, due to time constraints, it might not be feasible for the Commission to act upon the proposed elimination of short sale price tests prior to the Pilot Stocks Phase Date, then SIFMA would urge the Commission to provide exemptive relief so that firms would not be required to institute such needless programming changes.

IV. SIFMA supports the elimination and prohibition of any price test

For the above reasons, SIFMA strongly supports the Commission's proposed elimination of the tick test of Rule 10a-1. SIFMA also supports the Commission's proposal to prohibit any SRO from maintaining or enacting a price test with respect to any security, as the above-cited evidence from the Pilot clearly indicates that any price test, be it the Commission's or an SRO's, is unnecessary and even potentially harmful to the operation of the equity markets.

Moreover, to the extent that SROs were given the option of maintaining a price test, the SROs could feel pressured to maintain a price test as a marketing tool for attracting issuer listings. This would lead to an environment, as exists today, where there would be disparate price tests, or even no price test, depending on the market on which a security trades. Such a result imposes unnecessary compliance costs upon broker-dealers (without also providing real benefits to investors) and leads to regulatory arbitrage. Furthermore, such a situation might raise best execution concerns for broker-dealers deciding on how best to route short sale orders, *i.e.*, in that a broker-dealer would need to consider whether to route short sale orders received to a market that has a price test, as opposed to a market which does not and which could thus perhaps provide a faster

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[6] Securities Exchange Act Release No. 55160 (January 24, 2007).

execution. In response to the Commission's question in the Proposing Release, SIFMA supports the Commission providing clarity with respect to the "short sale price tests" that would be prohibited under the proposed amendments.

V. SIFMA believes that the Commission should not link the proposed elimination of the price test to the proposed amendments to Rule 105 of Regulation M

SIFMA notes that the Commission elected to contemporaneously propose amendments to Rule 10a-1 to eliminate short sale price tests, and certain amendments to Rule 105 of Regulation M, which governs short sale activity surrounding securities offerings. This being the case and to the extent the Commission may be contemplating considering both proposals at the same time, SIFMA would encourage the Commission instead to consider those amendments separately. In particular, as outlined in a separate comment letter relating to Rule 105 of Regulation M, SIFMA believes that the proposed Rule 105 amendments, as drafted, could actually result in potentially severe unintended consequences, including detrimentally impacting the capital formation process. In contrast, due to our view that the proposed elimination of short sale price tests is significantly less controversial, coupled with the burdensome and expensive programming costs associated with the price tests, SIFMA requests that the Commission proceed expeditiously with the proposed amendments to Rule 10a-1.

VI. SIFMA encourages the Commission and SROs to take steps to alter rules which cross-reference the price tests

SIFMA notes that there are other Commission and SRO rules which cross-reference the Rule 10a-1 tick test, and thus encourages action to be taken to resolve any open issues once the price test is eliminated. For example, the SRO short interest reporting rules currently exclude from reporting certain short positions resulting from short sales effected in reliance on enumerated exceptions from the tick test of Rule 10a-1. In this regard, SIFMA would urge the SROs to maintain such exceptions from short interest reporting (*e.g.*, the exceptions for syndicate short positions and short positions resulting from "long" sales) so that firms would not need to institute programming changes to report such short positions.

VII. Proposed elimination of "short exempt" marking requirement

Assuming the elimination of any and all short sale price tests, the Commission has also proposed to eliminate the current requirement in Rule 200(g)(2) of Regulation SHO to mark sales "short exempt," and to instead require sales to either be marked "long" or "short." SIFMA firms generally would prefer that the Commission preserve the "short exempt" marking requirement, specifically amending Regulation SHO to indicate that a sale should be marked "short exempt" if effected in reliance on an

exception from the "locate" requirement, pursuant to Rule 203(b)(2) of Regulation SHO.[7] Firms generally are of the view that preserving the "short exempt" marking for such situations should assist their compliance efforts by identifying short sales for which a locate is not required to be obtained.

Some SIFMA firms also would encourage the Commission to amend the definition of "long" sale, in Rule 200(g) of Regulation SHO, to avoid confusion, or unintended consequences, in situations where orders may currently be marked "short exempt." Specifically, as the Commission is aware, there is currently an exception from the price tests (the tick test of Rule 10a-1 and the bid test of NASD Rule 5100/NASDAQ Rule 3350), as well as from the Regulation SHO "locate" requirement, for situations where a seller owns the security being sold, but does not believe that the security will be available for delivery until shortly after settlement date. This exception is commonly relied upon for, among other things, sales of formerly-restricted securities pursuant to Rule 144 under the Securities Act of 1933, as amended.[8] In such situation, the seller does own the securities being sold, however such securities may not be able to be delivered on settlement date, due to delays in accumulating the necessary paperwork and/or having the transfer agent remove the "restricted" legend from the shares.

Some SIFMA firms believe that the Commission should clarify that any such sale may be marked "long" in order to avoid unintended consequences and mistaken perceptions by issuers and others as to the nature of the sale. These SIFMA firms believe that this could be accomplished by amending the definition of "long" sale in Rule 200(g) of Regulation SHO to state that: "An order to sell shall be marked 'long' only if the seller is deemed to own the security being sold pursuant to paragraphs (a) through (f) of this section and either: (i) The security to be delivered is in the physical possession or control of the broker or dealer; (ii) It is reasonably expected that the security will be in the physical possession or control of the broker or dealer no later than the settlement of the transaction; or (iii) The seller intends to deliver such security as soon as all restrictions on delivery have been removed and, if the seller has not delivered such

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[7] Rule 203(b)(2) provides an exception from the locate requirement of Rule 203(b)(1) for: "(i) A broker or dealer that has accepted a short sale order from another registered broker or dealer that is required to comply with paragraph (b)(1) of this section, unless the broker or dealer relying on this exception contractually undertook responsibility for compliance with paragraph (b)(1) of this section; (ii) 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; (iii) Short sales effected by a market maker in connection with bona-fide market making activities in the security for which this exception is claimed; and (iv) Transactions in security futures."

[8] *See* Q&A 4.9 of the Division of Market Regulation's *Responses to Frequently Asked Questions Concerning Regulation SHO* (citing footnote 71 of the Regulation SHO Adopting Release, which indicates that sales effected pursuant to Rule 144 may be entitled to rely on the exception in Rule 203(b)(2)(ii)).

security within 35 days after the trade date, the broker-dealer that effected the sale must complete delivery by borrowing or purchasing securities of like kind and quantity."

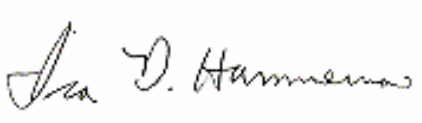
In the event that the Commission decides not to amend Rule 200(g) in this manner, SIFMA would strongly encourage the Commission to continue to allow firms to mark such sales "short exempt," in reliance on the exception from the Regulation SHO "locate" requirement, found in Rule 203(b)(2)(ii).

VIII. Conclusion

SIFMA commends the Commission for the careful and thorough manner in which it has evaluated the impact of short sale price test restrictions, which culminated in the decision that these restrictions are no longer necessary to achieve their stated objectives and thus should be removed. SIFMA fully supports the elimination of all such restrictions, and urges the Commission to take such action prior to the implementation of Reg NMS.

If you have any questions or require additional information, please do not hesitate to contact the undersigned or Ann Vlcek, SIFMA Vice President and Associate General Counsel, at 202-434-8400. Thank you for your attention to this request.

Sincerely,



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