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Securities and Exchange Commission Short Sale Restrictions Roundtable May 5, 2009

Rosenblatt Securities is pleased and honored to participate in this roundtable on proposed short-sale restrictions. The topic of short selling evokes strong passions and disparate viewpoints. We commend the commission for carefully considering, through extensive consultation with market participants, the merits and potential effects of any new or modified regulations pertaining to short sales.

Rosenblatt Securities is an institutional brokerage based in New York. We execute trades on an agency-only basis for managers of mutual funds, pension funds, hedge funds and other investment firms. Institutions such as these manage the vast majority of US retail investors' equity investments. The Investment Company Institute, for example, estimates that some $3.3 trillion is currently invested in equity mutual funds alone. This money comes from ordinary Americans saving for college, retirement and other essential financial goals. Changes to market structure arising from regulation often profoundly affect the ability of these institutions to efficiently and effectively execute securities transactions on behalf of their clients. Any negative effects of this nature can, in turn, impair the investment returns these institutions can achieve for customers. And because the secondary markets exist to support capital formation, such adverse consequences also can damage the overall health of our economy. It is therefore vitally important to consider whether any proposed short-sale regulations will bring clearly demonstrable benefits that outweigh their potential adverse impact on market quality.

Because Rosenblatt engages in no principal or proprietary trading, our interests are the same as those of the investing public we serve. And while we believe that any new price tests would have a minimal direct impact on our own internal operations, we are concerned about the potential negative effects on market quality — both obvious and unforeseen — of additional measures to restrict short sales.

As part of its brokerage services, Rosenblatt also analyzes and advises its clients about market structure. In this role we have fostered close relationships with a wide variety of market participants, including exchanges, ATSs, investment companies and other broker/dealers, that provide us with a unique perspective on how competitive dynamics and regulation affect market quality. Of particular importance to today's discussion, we have developed an intimate knowledge of the role played by so-called high-frequency traders and other critical providers of liquidity in the securities markets. These high-frequency firms pursue a variety of strategies, most of which involve the placing and cancelling of hundreds (and sometimes thousands) of orders per second, guided by the instructions of highly sophisticated algorithms. We estimate that high-frequency firms as a whole account for as much as two-thirds of consolidated US equity volume. The majority of high-frequency activity, in our opinion, involves a net provision of liquidity to the equity market. Indeed, as our market structure has changed dramatically in recent years — in large part as a result of regulatory measures such as decimalization, Regulation ATS and Regulation NMS — these firms have become the market's new primary liquidity providers, supplanting NYSE specialists and traditional Nasdaq market makers.

High-frequency traders and other market participants regularly engage in short sales. In so doing, they are most often not taking fundamental views on the securities in question. Rather, they take temporary positions, determined by quantitative models, that are often covered or hedged very quickly. Quite frequently their short positions are part of complex strategies, many of which involve corresponding or related long positions in the same or comparable securities.

All of the proposals floated in the commission's release regarding additional short-sale restrictions would have some negative impact on these benign and vital forms of short selling. For a report that we completed recently on the potential impact of certain regulatory initiatives on market volumes and liquidity, we surveyed approximately a dozen high-frequency trading firms. The vast majority

indicated that the reinstatement of a price test for short sales would cause them to diminish their trading activity, some by as much as 20 percent. We believe that this would cause bid-ask spreads to widen and liquidity to diminish, resulting in greater inefficiency and higher net transaction costs for the traditional institutions that manage the vast majority of the wider investing public's assets.

More broadly speaking, short selling is a vital part of a vibrant and efficient market. In addition to short sales executed by high-frequency traders that are driven by non-fundamental factors and provide massive amounts of liquidity to the market, short sales by market participants taking a view on the fundamentals of a particular security also contribute to the richness and diversity of opinions that must interact to maximize market efficiency. We agree with the considerable empirical evidence the Commission has amassed which suggests that price tests do nothing to diminish volatility or stop supposed "bear raids" on individual securities, even in highly volatile markets. Additionally, a bid or tick test, even governed by a circuit breaker, is highly impractical in light of the way markets have evolved in recent years. This transformation fragmented trading among dozens of execution venues, tightened spreads, reduced displayed size and paved the way for the high-speed, algorithmic trading I described earlier, which now dominates overall volumes. This makes designing and implementing systems that can detect and prevent short sales unless there is a plus tick, or zero plus tick, extraordinarily difficult and costly.

Given the strong possibility that price tests will adversely affect market quality, we must ask ourselves whether their imposition would ameliorate market ills and perhaps justify some negative side effects. To be sure, there are circumstances under which short sales can take different forms from those which I described earlier — forms that constitute abuse or manipulation. One such form is naked short selling, which can cause failures to deliver sold shares to buyers at settlement. Naked shorting, by encouraging short sales beyond the quantity of shares that may be reasonably located and borrowed, could also contribute to artificially large decreases in the prices of securities being sold short. We are encouraged by the Commission's intent to make permanent last year's Temporary Emergency Order Rule 204T, which requires firms to buy-in short fails to deliver prior to market open on T+4, effectively eliminating naked short sales within the industry. Rule 204T has the teeth that the buy-in provisions of Reg SHO lacked. In fact, it goes even further, by requiring clearing firms to buy in long sales of any securities in which any client has failed to deliver shares. The near-elimination of Reg SHO threshold securities as a result of these measures, as illustrated by the Commission staff during its open meeting last month, means that naked shorting has been effectively neutralized as a market problem. We would also argue that the Commission should consider eliminating the so-called locate requirement for brokers, as it does not constitute the borrowing of shares at all, but rather presents an unnecessary step in the short-sale process that slows down brokers in fast markets. The "locate" is especially unnecessary because customers are now bought in immediately, even as early as the close of business on T+3, if they fail to deliver.

Other forms of short selling that constitute abuse or manipulation, such as short sellers spreading false negative rumors about companies or acting in concert to drive down share prices, can be addressed through the Commission's current antifraud and enforcement powers. We have many laws and regulations currently on the books to protect the public from the manipulation of stock prices. If in fact these are being aggressively enforced, then the fallout from manipulative short selling should be minimal. But if we are not enforcing these rules well enough to avoid abuse by predatory short sellers, we must improve those efforts rather than mask insufficient enforcement with new short selling restrictions.

Of course, the elephant in the room here is politics. Certain members of Congress, along with representatives of publicly traded companies, believe that restoring the uptick rule or some form of price test will provide a much-needed boost to the confidence of investors who have been wracked by swift and deep losses resulting from the financial crisis that began last year. We certainly appreciate the importance of confidence during times of crisis. But we also are mindful that major equity market indexes have rallied 33 percent since their early-March nadir, and that many economists, analysts and corporate executives are now voicing their belief that the worst of the crisis is behind us. While they could be wrong, the need for an immediate short-term boost to confidence does not appear to be acute at this point in time. And in any event, the advise-and-comment process

that the Commission is so wisely pursuing with respect to these potential new regulations, as well as the likelihood that implementation could require new technology and operational procedures to be put in place by market participants, means that any new restrictions likely would not take effect until several months from now. More importantly, imposing regulations that are likely to do more harm than good, simply for optics' sake, strikes us as extraordinarily poor public policy.

If, however, the Commission determines that new restrictions are in order, we believe that a price test triggered on an individual-security basis by circuit breakers would bring the fewest adverse effects on market quality. More importantly, we strongly urge the Commission to consider exemptions to any new short-sale restrictions that would permit high frequency and other market makers to continue to provide the same robust level of liquidity to the market that they do today.

Once again, thank you for seeking the opinions of market participants regarding this highly charged and complex issue, and for the opportunity to participate in this roundtable. I am happy to entertain any questions you may have.