March 24, 2009

The Honorable Mary Schapiro
Chairman
U.S. Securities and Exchange Commission
100 F Street NE
Washington, DC 20549

Dear Chairman Schapiro:

The United States national securities exchanges welcomed the announcement that the Securities and Exchange Commission (the Commission) will consider a proposal to adopt a rule to combat abusive short selling. Abusive short selling harms investors and the companies listed on our exchanges, and destroys the overall confidence in our capital markets. Our challenge is to restrict abusive short selling while still permitting liquidity creating short selling that continues our status as the most efficient capital market in the world. As you know, we worked closely with the Commission to implement new rules and emergency measures to combat abusive short selling during 2008. We also applaud the Commission for pursuing new restrictions while permitting a full opportunity for comment given the complexity of our markets and the technology that currently supports our markets. Continuously attacking abusive short selling and other manipulative activities is critical to restoring public confidence in the US equities markets.

First, let us commend the Commission in its efforts to attack an abusive form of short selling; "naked short selling" in combination with failures to deliver. On September 17, 2008, 2008, the Commission adopted interim final Rule 204T under Regulation SHO to restrict and penalize brokers and their customers for failures to deliver securities.[1] As a result, the number of securities with significant failures to deliver on the "Threshold" lists has decreased by over 95 percent, from over 400 prior to the adoption of the rule to fewer than 20 today.

More recently, there has been a great deal of discussion around reintroducing old rules that were designed to regulate short selling. As operators of the US equities markets that applied the original Short Sale Rule (the "Uptick Rule") in our trading systems and enforced broker-dealer compliance with that rule, we are well-positioned to help the Commission to review possible short selling restrictions. The original Uptick

---

[1] *See* Exchange Act Release No. 58572 (Sept. 15, 2008); Exchange Act Release No. 58166 (July 15, 2008).

Rule, whereby short selling could occur only when the last sale was at or above the previous sale, operated for a long period of time, is understood by the trading community, and is supported by issuers. However, the original Uptick Rule would likely prove difficult to implement and enforce in our current penny increment market structure and would not be as prohibitive in today's market where transaction prices change multiple times in a single second and message traffic has exploded to billions of messages storming down on our markets every day. As such, we are proposing a slightly altered and modernized version of the previous Uptick Rule, which we will refer to as the "Modified Uptick Rule."

The Commission can, we believe, adopt a similar but simple, effective and more prohibitive Short Sale restriction that takes into account how equity trading has changed over the past several years since the original Uptick Rule was eliminated. The exchanges have worked in a coordinated and unified approach to craft a proposal that will deliver appropriate restrictions on abusive short selling practices. Under our Modified Uptick Rule, short selling can only be initiated at a price ***above*** the highest prevailing national bid by posting a quote for a short sale order priced above the national bid. As such, the execution of a short sale would occur only at a higher price than the prevailing market at the time of initiation, and only on a passive basis (i.e., short sales cannot hit bids). This restriction would greatly assist the prevention of manipulative short selling, which is so harmful to the markets.

This Modified Uptick Rule is superior to the original Uptick Rule in several ways. It is conceptually simple, likely to be more effective in dampening downward price pressure, and easier to program into trading and surveillance systems than the original Uptick Rule. We understand that no solution is perfect but we believe the Modified Uptick Rule that we are proposing is the most effective solution to deal with the faster-moving, post-Regulation NMS trading environment and to reduce downward pressure on stocks created by abusive short selling. In addition, we believe the most practical and effective way to structure adherence to the Modified Uptick Rule would be similar to oversight of the Trade-Through Rule under Regulation NMS. In this vein, the Modified Uptick Rule would be a policies and procedures requirement, and brokers would have responsibility for ensuring compliance with the rule before sending a short sale order into the marketplace. Exchanges could offer order types to assist brokers in performing their compliance duties, but would rely on a broker's indication that they had performed the required due diligence on the order when so indicated.

In combination with the adoption of this Modified Uptick Rule or any short sale price test, we urge the Commission to also adopt a "Circuit Breaker" that would trigger the application of the Modified Uptick Rule only after the price of a stock has experienced a precipitous decline by a certain percentage, perhaps ten percent. Our national markets and many foreign markets have successfully used circuit breakers on both broad indexes and individual securities for many years. A Circuit Breaker permits normal market activity while a stock is trading in a natural range and short selling is more likely to benefit the market (by, for example, increasing price discovery and liquidity). Conversely, a Circuit Breaker will restricts short selling when prices begin to decline substantially and short selling becomes more likely to be abusive and harmful. The Circuit Breaker is particularly efficient in stable and rising markets because it avoids imposing continuous monitoring and compliance costs where there is little or no corresponding risk of abusive short selling.

We focus here only on the broad concepts of the Modified Uptick Rule and a Circuit Breaker to highlight their importance. There are, of course, details of the Modified Uptick Rule about which the exchanges can and will comment further. For example, with respect to the Modified Uptick Rule, the exchanges have views regarding the benefits of bona fide market making in both equities and options markets, and on the need for clear and precise guidance on what constitutes bona fide market making and for an exemption for market makers. Additionally, we believe firms need to know what policies and procedures they must adopt to promote compliance with the Rule, and whether exchanges can assume that short sale orders have been checked properly for compliance with the Rule.

With respect to the Circuit Breaker, questions exist about the proper reference price for calculating it and about the duration of the Circuit Breaker once triggered. Also, the network processors must determine how to disseminate an indication that a Circuit Breaker has been triggered and, later, lifted. The exchanges, member firms, and network processors must also provide estimates of programming and testing requirements for both the Circuit Breaker and the Modified Uptick Rule. As always, we know the Commission will consider implementing rules in a time-line that carefully balances the risks of the behavior being regulated against the risks of disrupting the very markets that operated efficiently throughout this crisis.

We applaud the Commission for tackling this important and difficult issue. Commission leadership and expertise, along with active engagement by investors, issuers, firms, and exchanges, will lead to a positive outcome and help restore investor confidence in the US equities markets.

cc: The Hon. Kathleen L. Casey, Commissioner
The Hon. Elisse B. Walter, Commissioner
The Hon. Luis A. Aguilar, Commissioner
The Hon. Troy A. Paredes, Commissioner
Dr. Erik R. Sirri, Director, Division of Trading and Markets,