AMERICAN BANKERS ASSOCIATION

1120 Connecticut Avenue, NW
Washington, DC 20036

1-800-BANKERS
www.aba.com

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Carolyn Walsh
Senior Counsel
Center for Securities, Trust and Investments
Phone: 202-663-5253
Fax: 202-828-5047
cwalsh@aba.com

Submitted Via Internet

December 16, 2008

Florence E. Harmon
Acting Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Amendments to Regulation SHO (Interim final temporary rule), File Number S7-30-08, 73 Federal Register 61706 (October 17, 2008); and Disclosure of Short Sales and Short Positions by Institutional Investment Managers (Interim final temporary rule), File Number S7-31-08, 73 Federal Register 61678 (October 17, 2008).

Dear Ms. Harmon:

The American Bankers Association[1] appreciates the opportunity to offer these comments on the Securities and Exchange Commission's (SEC) recent interim final temporary rules relating to Amendments to Regulation SHO and Disclosure of Short Sales and Short Positions by Institutional Investment Managers (File Nos. S7-30-08 and S7-31-08). The ABA appreciates that these interim final rules are part of a larger effort undertaken by the SEC to maintain orderly and fair markets during this financial crisis, and we strongly support the SEC's efforts in this regard.

ABA recognizes that short selling can be a legitimate and important financial tool. Legitimate short selling can operate as a mechanism for generating market liquidity, securing price discovery, and fostering corporate accountability and responsibility. That said, ABA has been supportive of the SEC's actions to restrict short selling in the recent extreme circumstances where it has been distorted into a tool for market manipulation and abuse, and we would be supportive of additional short selling bans if market conditions warrant such action. However, as we explain more fully below, we see a stark contrast

[1] The American Bankers Association brings together banks of all sizes and charters into one association. ABA works to enhance the competitiveness of the nation's banking industry and strengthen America's economy and communities. Its members – the majority of which are banks with less than $125 million in assets – represent over 95 percent of the industry's $13.6 trillion in assets and employ over 2 million men and women.

between allowing legitimate short selling to continue, and failing to take adequate steps to prevent manipulative and abusive naked short selling to flourish.

It has been widely recognized that naked short selling has a higher risk of settlement failure and may distort the operations of financial markets by causing increased price volatility and potentially facilitating market manipulation. Our members have informed us that they have and continue to experience these excessive fluctuations and market disruptions since July when banks of all sizes saw precipitous drops in stock prices, extremely high trading volumes, and huge spikes in failures to deliver (FTDs). Our members believe that the price volatility generated by this short selling activity is unrelated to fundamental valuation issues and remain concerned that the activities of abusive naked short sellers threaten the fair and orderly operation of our capital markets. Moreover, these disruptions are especially problematic for our member banks as bank customers frequently—and incorrectly—equate significant drops in bank stock prices with safety of bank deposits. At a time when the economy is clearly under stress, the Commission has a responsibility to ensure that destructive practices such as abusive naked short selling are addressed.

Recommendations

Study if a "Pre-Borrow" Requirement, Rather than a "Hard Close" Requirement would Provide for a Better Level of Protection Against Naked Short Selling. Since the origination of Regulation SHO in 2005, the number of companies listed on Regulation SHO's threshold security list has continued to rise. While we recognize that recently there has been a substantial drop in the number of new firms suffering from settlement failures serious enough to be placed on the Threshold List, it remains to be seen whether that drop is a result of the stricter delivery requirements imposed by the Interim Rules, or simply the decline in capital market activity in general. Moreover, the information provided on the Threshold List does not inform the public, or issuers, about whether FTDs continue to exist and are just being closed out faster, thus avoiding placement on the Threshold List.

The SEC has stated that its goal in enacting the interim temporary rule is to "eliminate any possibility that abusive 'naked' short selling, as well as persistent fails to deliver, will contribute to the disruption of markets in equity securities and thereby, will help ensure that investors remain confident that trading can be conducted without the illegal influence of manipulation."[2] We are concerned that the "hard close" requirement attempts to deal with the problem of naked shorts in an after the fact fashion by imposing penalties on short sellers who are unable to deliver securities. If the price of the shorted stock is declining, the mandatory close out can be accomplished for a net gain. However, if the price of the security is gaining, there may not be sufficient motivation to closeout, especially because the SEC has yet to clarify what the penalty is for failure to comply with the close-out requirement.

Therefore, we believe that the SEC should study the impact of the "hard close" rule on *eliminating FTDs*, not just reducing the number of firms on the Threshold List. Further, the SEC should consider whether a simpler and more effective way to eliminate naked shorts would be to

[2] Amendments to Regulation SHO (Interim final temporary rule),
File Number S7-30-08, 73 Federal Register 61706, 61728 (October 17, 2008).

impose a "pre-borrow" requirement on all short sales. Authorities such as former SEC Chairman Harvey Pitt have suggested that short sellers must have a legal responsibility to deliver the securities and buyers have a legally cognizable right to the security at settlement. It may very well be appropriate to build these legal rights and responsibilities in to any "pre-borrow" requirement.

Develop Meaningful Disclosure Rules. A major principle of the US securities regulation is enhanced transparency. Currently, there is a lack of parity between public disclosure of long and short positions under the securities laws. As one of our bankers has said, "I know who is long in my stock, why can't I know who is short in it as well?" We believe that it now makes sense for the SEC to consider whether there is some manner in which short sale information could be made available to the public on a delayed basis. A delayed basis could alleviate short sellers concerns regarding disclosure of proprietary trading information. We also recognize that any short selling disclosure cannot be similar in form to that required for investors who are long in the stock. Short selling disclosure based on an "as of" date is subject to manipulation. At a minimum, we believe the SEC should consider requiring more frequent and prompt reporting of FTDs. Issuers receive information on short selling in their stock on the 15th and 30th of the month. FTDs should be reported at least as frequently.

Continue Efforts to Monitor and Root Out Manipulation in the Securities and Credit Default Swaps of Financial Institutions. The SEC recently announced examinations of hedge fund managers, broker-dealers, and institutional investors with significant trading activity in financial issuers to root out the spread of false and misleading information. We welcome this effort to investigate problems in the current volatile market environment. We do not believe, however, that aggressive enforcement of existing regulations is the preferred deterrent to illegal and abusive short selling. As leading authorities in SEC enforcement have recognized, successfully prosecuting manipulative short selling conduct and appropriately punishing wrongdoers is difficult, to say the least. Moreover, because we believe the likelihood of being able to prosecute successfully significant numbers of manipulative short selling cases is remote, these efforts to bring reform to the industry through examination and enforcement likely will not be lasting. Therefore, while we support the SEC's efforts to police the markets to the extent practicable, we believe that the problem of manipulative short selling must ultimately be addressed through the development of thoughtful, effective regulation.

Re-instate a Modified "Uptick Rule". The "Uptick Rule", which was enacted in 1938, was created to help limit downward spirals by allowing stock to be sold short only after a rise from its immediately prior price. The SEC eliminated this rule in July 2007. We understand that the decision to eliminate the "Uptick Rule" was made after the SEC conducted a pilot program to study the effectiveness of the rule. At that time, the SEC concluded that market changes, including decimalization and program trading, had rendered the rule ineffective. Moreover, the SEC was concerned with the operation of the "Uptick Rule, as it was alleged that it interfered with the efficiency of electronic trading platforms. However, because the pilot was conducted in a period of a rising market with low volatility we believe that it is appropriate for the SEC to reexamine this decision. We believe that it may be helpful for the SEC to study whether some sort of market mechanism should be installed that prohibits short selling in a stock for some

period of time when some benchmark has been reached. We wish to emphasize, however, that any such mechanism must have an exemption for market makers.

Our markets today are operating under vastly different conditions from what they were in July 2007. Demand curves for securities are sloping sharply downward. If short sellers, especially naked short sellers, can operate without the restriction of some sort of "Uptick Rule", they can generate lower prices than would be reached if only the outstanding securities were available for trade in the market. The effect of eliminating the "Uptick Rule" during this time of market turbulence appears to have been dangerously pro-cyclical. It is not sufficient to say that because the "Uptick Rule" was not terribly effective during the period of the pilot program, that it should not be reinstated. We therefore join the rising chorus of organizations, individuals and members of Congress in stating that given the current state of the market, re-imposition of some sort of modified "Uptick Rule" is essential to fulfilling the SEC's mission of maintaining fair and orderly markets.

Consider whether reforms to the clearance and settlement system are appropriate. We understand that there have been some arguments made that there is a significant amount of short selling that is being conducted outside of DTCC's Continuous Net Settlement system and that this information is not being disclosed to the public. We also understand that abusive short selling may be limited if the securities markets were to move from a T+3 to a T+0 settlement environment. While we understand that reforming the clearance and settlement system raises many difficult legal and operational issues apart from limiting abusive short selling, it may be appropriate for the SEC to consider what, if any, changes should and could be made to these systems. Technological advances may have rendered the most significant obstacles to a T+0 settlement standard out of date.

Conclusion

The SEC's recent efforts to ban naked short selling are very much appreciated. In that regard, we recognize the need for working with global regulators to arrive at a consistent regulatory approach and welcome Chairman Cox's statement that "it is essential not only that regulators act against securities law violations, including abusive short selling, but also that there be close coordination among international markets to avoid regulatory gaps and unintended consequences."[3] However, more can and should be done with respect to promulgating regulations to halt manipulative short selling. ABA greatly appreciates the consideration of the issues raised above. We would be pleased to discuss these comments in greater detail with the Commission.

Sincerely,

Carolyn Walsh

[3] SEC Chairman Cox Statement on Meeting of IOSCO Technical Committee, http://www.sec.gov/news/press/2008/2008-279.htm (Nov. 24, 2008).