

MEMO# 22514

May 16, 2008

ICI Draft Comment Letter on the SEC's Proposed Anti-Fraud Short Sale Rule

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TO: EQUITY MARKETS ADVISORY COMMITTEE No. 22-08
ETF ADVISORY COMMITTEE No. 10-08
SEC RULES COMMITTEE No. 36-08
CLOSED-END INVESTMENT COMPANY COMMITTEE No. 22-08 RE: ICI DRAFT COMMENT
LETTER ON THE SEC'S PROPOSED ANTI-FRAUD SHORT SALE RULE

As we previously informed you, the Securities and Exchange Commission recently published for comment proposed Rule 10b-21 under the Securities Exchange Act of 1934 – an anti-fraud rule designed to address failures to deliver securities that have been associated with “naked” short selling. [\[1\]](#)

Comments on the proposal are due to the SEC by May 20, 2008. Please provide any comments on the Institute's draft letter to the undersigned no later than Monday, May 19. Comments may be provided by phone (202-326-5920), fax (202-326-5839), or email (htraeger@ici.org).

The Institute's draft letter supports the Commission's proposal to target naked short selling. Specifically, the proposed rule would make it an anti-fraud violation for a short seller to deceive certain specified persons about their intention or ability to deliver securities in time for settlement, including short sellers that deceive their broker-dealer about the source or ownership of shares, and that fail to deliver securities by settlement date. [\[2\]](#) The proposed rule also would include a scienter requirement. The Institute's letter seeks clarification on several aspects of the proposal.

Scienter and Delivery Requirement

The draft letter strongly supports the scienter requirement in the proposed rule, to avoid capturing inadvertent, temporary fails to deliver. It seeks confirmation from the Commission that a systems error would not be a violation of the rule. The draft letter also states that the proposed rule's delivery requirement (i.e., failure to deliver the securities by settlement date) is unnecessary if the scienter requirement is adopted.

Locate Requirement

The draft letter supports the locate requirement in the proposed rule as long as the Commission continues to permit a broker-dealer to rely on customer assurances, provided it is reasonable for the broker-dealer to do so, in satisfying the requirement. The letter explains that the potential costs of requiring investors to provide definitive proof that they own the security they are seeking to sell or to deliver the security to the broker-dealer prior to entering a sell order would significantly outweigh the benefits of such a requirement.

To address concerns regarding potential information leakage, the draft letter seeks clarification that a short seller would not have to disclose, under the proposed rule, the source of any borrowed securities and that a seller must only disclose that it is "deemed to own the securities" as described in Regulation SHO. The draft letter also recommends that, if the Commission adopts the proposed rule, it abandon its outstanding proposal that would require broker-dealers to document the present location of securities being sold in any sale transaction marked as a "long" sale. [\[3\]](#)

Application of the Proposed Rule to ETFs

The draft letter seeks clarification regarding the application of the proposed rule to ETFs. The draft letter raises a number of questions that the Institute believes should be addressed prior to adoption of the proposed rule, particularly surrounding the ETF creation and redemption process.

Enforcement of Short Sale Rules

The draft letter notes that the Institute does not support "rulemaking for the sake of rulemaking" but recognizes that the proposed rule will highlight the illegality of abusive naked short selling activities and the harm that these activities have on the securities markets. Accordingly, the draft letter recommends that the Commission's efforts to minimize "naked" short selling be accompanied by vigorous enforcement of the current and proposed short sale and anti-fraud rules.

Heather L. Traeger
Assistant Counsel

[Attachment](#)

endnotes

[1] See Memorandum to Equity Markets Advisory Committee No. 15-08, ETF Advisory Committee No. 6-08, SEC Rules Committee No. 26-08, and Closed-End Investment Company Committee No. 12-08, dated March 28, 2008 [22381].

[2] See SEC Release No. 57511 (March 17, 2008), 73 FR 15375 (March 21, 2008).

[3] See SEC Release No. 56213 (August 7, 2007), 72 FR 45558 (August 14, 2007).

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