

**MEMO# 23526**

June 11, 2009

## **Draft ICI Comment Letter on Short Sale Regulation; Conference Call Scheduled for June 15**

[23526]

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TO: EQUITY MARKETS ADVISORY COMMITTEE No. 24-09  
ETF ADVISORY COMMITTEE No. 12-09  
SEC RULES COMMITTEE No. 33-09  
CLOSED-END INVESTMENT COMPANY COMMITTEE No. 9-09 RE: DRAFT ICI COMMENT  
LETTER ON SHORT SALE REGULATION; CONFERENCE CALL SCHEDULED FOR JUNE 15

As we previously informed you, the Securities and Exchange Commission ("SEC") has published for comment a proposal containing two general approaches to restrictions on short selling. One approach would apply a price test on a market wide and permanent basis, similar to the former "bid test" or the former uptick rule under Rule 10a-1 of the Securities Exchange Act of 1934. [\[1\]](#) The second approach would apply only to a particular security during a specified market decline in that security (a "circuit breaker"), and would impose either a temporary price test or a temporary halt in trading in the affected security. The Institute has prepared the attached draft comment letter on the proposal. The most significant aspects of the letter are summarized below.

Comments on the proposal are due to the SEC by June 19, 2009. We will hold a conference call on Monday, June 15 at 2:00 p.m. Eastern time to discuss the draft comment letter. The dial-in number for the call will be 1-866-541-3298 and the passcode will be 6501781. If you plan to participate on the call, please contact Jennifer Odom by email at [jodom@ici.org](mailto:jodom@ici.org) or by phone at 202-326-5833.

### **Proposed Restrictions on Short Selling**

The draft comment letter states that new restrictions on short sales are not warranted at this time. It specifically states that the Commission should rely on the current short sale regulations and anti-fraud and anti-manipulation provisions of the securities laws to address potentially abusive short selling. It also questions whether price restrictions on short selling will address the Commission's concerns in this area or will necessarily restore investor confidence lost due to recent events in the securities markets. In support of this position, the Institute's letter explains that there is not only an absence of empirical evidence to support new short sale restrictions but also a substantial risk of unintended consequences from new short sale restrictions that could decrease liquidity, market efficiency, and price discovery. The letter notes that the position described above is a consensus opinion among Institute members and that some fund groups believe that the Commission should adopt some form of short sale price restriction.

The letter states that, if the Commission determines that it must proceed with one of the proposed restrictions, it should opt for a circuit breaker triggering the proposed modified uptick rule, as the least damaging solution for the markets. The letter recommends, however, that the Commission increase the threshold percentage trigger to greater than the proposed 10 percent. It also supports the proposal to limit the period of the price restriction to the remainder of the trading day.

### **Other Issues Relating to Proposed Restrictions on Short Selling**

The draft letter addresses a number of additional issues that the Commission will have to consider prior to implementing any new short sale restrictions. Significantly, the letter supports appropriate exceptions to any short sale restrictions the Commission may adopt. Specifically, it supports exceptions for exchange traded funds, market makers, and certain benchmark order types, including volume-weighted average price orders. Noting the deficiencies present under the prior short sale price test regime, the letter states that any new short sale regulation must include a robust inspection and enforcement regime. Finally, the letter recommends that, if the Commission determines that some form of short sale restriction is necessary, the Commission should implement such restriction on a pilot basis.

### **Settlement of Short Selling Transactions and Pre-Borrowing Requirements**

The letter discusses the suggestion that concerns relating to short sales could be addressed through a continued tightening of requirements relating to the Commission's close-out requirements for fail to deliver positions. It states that, at this time, and without further study of the potential impact on the securities markets, the Institute would not support a restriction on short selling that would be based on a pre-borrow requirement. The letter also encourages the Commission to continue to review the implications of new short selling rules on securities lending and to address any unintended consequences for, or impediments to, the effective operation of the securities lending markets.

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Associate Counsel

[Attachment \(in .pdf format\)](#)

**endnotes**

[1] See [Memorandum](#) to SEC Rules Committee No. 18-09, Equity Markets Advisory Committee No. 17-09, ETF Advisory Committee No. 9-09, and Closed-End Investment Company Committee No. 5-09, dated April 20, 2009 [23407].

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