

MEMO# 23116

December 10, 2008

ICI Draft Comment Letters on SEC Interim Final Rules to Address Manipulative Short Sale Activity; Comments Requested by December 15

[23116]

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TO: ACCOUNTING/TREASURERS COMMITTEE No. 21-08
CHIEF COMPLIANCE OFFICER COMMITTEE No. 21-08
CLOSED-END INVESTMENT COMPANY COMMITTEE No. 34-08
COMPLIANCE ADVISORY COMMITTEE No. 19-08
ETF ADVISORY COMMITTEE No. 36-08
EQUITY MARKETS ADVISORY COMMITTEE No. 64-08
INVESTMENT ADVISERS COMMITTEE No. 11-08
SEC RULES COMMITTEE No. 87-08 RE: ICI DRAFT COMMENT LETTERS ON SEC INTERIM
FINAL RULES TO ADDRESS MANIPULATIVE SHORT SALE ACTIVITY; COMMENTS REQUESTED
BY DECEMBER 15

As we previously informed you, the Securities and Exchange Commission has published two interim final rules to address market manipulation and abuses related to short selling. [\[1\]](#) The first – temporary interim final Rule 10a-3T – requires institutional investment managers to report to the Commission certain information concerning their short sales and short positions. [\[2\]](#) The second – temporary interim final Rule 204T – requires broker-dealers to purchase or borrow securities to close out fail to deliver positions. [\[3\]](#) The Institute has prepared the attached draft comment letters on the interim final rules. The draft letters are summarized below.

Comments on the interim final rules must be filed with the Commission no later than Tuesday, December 16. Please provide your comments on the draft letters as soon as possible to Heather Traeger by phone at (202) 326-5920 or by email at htraeger@ici.org.

The draft comment letter supports interim final Rule 10a-3T and the Commission's need to obtain information from institutional investment managers to analyze the effects of its rulemaking relating to short sales and to consider when questions about the propriety of certain short selling occur. The letter urges the Commission, however, to balance these needs with the regulatory burdens imposed on market participants by the new disclosure requirements and the potential unintended consequences of those requirements. Most importantly, the letter requests that the Commission retain the portion of the interim final rule that makes the information submitted under the disclosure requirements non-public. The letter also makes the following recommendations to reduce the costs and burdens on investment managers subject to the required disclosures.

The draft letter recommends that Form SH be filed on a more reasonable and appropriate timeframe, such as quarterly, instead of the weekly period provide by the interim temporary final rule. It suggests that such a filing requirement would more appropriately balance the Commission's need to monitor short sale activity with the costs and burdens of producing Form SH data.

Among other clarifications, the draft letter recommends that the Commission clarify that when investment managers are deemed to share investment discretion only because of control relationships and affiliates do not share information about investment decisions for business purposes, short positions of affiliates should not be required to be aggregated to determine whether there is a reportable short position for the affiliate group.

The interim final rule includes a filing exception with two separate prongs that must be satisfied before an investment manager is entitled to operate under it: a "fair market value" test and a "percentage of shares outstanding" test. The letter recommends that the threshold in the "percentage of shares outstanding" test be increased from 0.25 percent to more accurately reflect the capture of positions with the potential to materially affect the price of the underlying securities. It also recommends that the Commission bifurcate the two-part test into separate standards, either of which may be satisfied for an investment manager to qualify for the reporting exception.

The draft letter requests that the Commission require only the disclosure of short positions instead of short sales and short positions. It states that such a limitation would provide the Commission with the information it needs to evaluate any significant market impact of a manager's short activity while appropriately balancing the high costs on market participants of developing and operating new systems to collect, compile, and reconcile short sale activity data.

The letter concludes by urging the Commission to work closely with foreign regulators to create consistent and sensible cross-border regulations for short sale activity. It emphasizes the importance of avoiding negative consequences of incongruent regulatory requirements and capitalizing on regulatory synergies as fund managers pursue an increasing cross-border presence in the interest of shareholders.

The draft comment letter supports interim final Rule 204T and the Commission's effort to inhibit abusive "naked" short selling through the requirement that securities be purchased or borrowed to close out any fail to deliver position. The letter encourages the Commission, however, to consider the unintended consequences that the interim final rule may have on the securities lending market and to adopt any appropriate modifications. Specifically, the letter explains that certain technical and operational aspects of Rule 204T associated with the timing and close-out process may act as a disincentive to investment managers to lend

their securities. It explains that a reduction in securities lending programs will impinge on the liquidity and price discovery benefits of short selling contrary to the Commission's goal underlying adoption of the interim final rule.

Heather L. Traeger
Assistant Counsel

[Attachment](#)

endnotes

[1] See Memorandum to ETF Advisory Committee No. 32-08, Equity Markets Advisory Committee No. 56-08, SEC Rules Committee No. 74-08, Closed-End Investment Company Committee No. 33-08, Accounting/Treasurers Committee No. 13-08, Chief Compliance Officer Committee No. 17-08, Compliance Advisory Committee No. 17-08, and Investment Advisers Committee No. 10-08, dated October 23, 2008 [23013].

[2] See Disclosure of Short Sales and Short Positions by Institutional Investment Managers, SEC Release No. 58785 (October 15, 2008), 73 FR 61678 (October 17, 2008).

[3] See Amendments to Regulation SHO, SEC Release No. 58773 (October 14, 2008), 73 FR 61706 (October 17, 2008).

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