

COMMENT LETTER

June 24, 2009

New Restriction on Short Sales Are Unnecessary, ICI Tells SEC

New Restriction on Short Sales Are Unnecessary; Investor Protections in Place, ICI Tells SEC
Washington, DC, June 24, 2009 – New restrictions on short selling are not warranted at this time, particularly in light of recent regulatory actions that have added necessary protections to the markets and addressed concerns relating to abusive short selling, [ICI stated in a comment letter](#) to the U.S. Securities and Exchange Commission.

Background

A short sale is the sale of a security that the seller does not own but is committed to repurchasing eventually. In general, short selling is used to profit from an expected downward price movement in a security. If that decline occurs, the short seller can “close out” the short position by purchasing equivalent securities on the open market and returning the borrowed shares at the lower price.

A legitimate trading strategy, short selling provides important benefits to the markets, including enhanced liquidity and pricing efficiency. Short selling also allows for hedging of the risk of an economic long position in the same security or in a related security.

Given the nature of the strategy, short selling often has been blamed for causing or contributing to market downturns. Such sentiments have prompted regulatory restrictions on the practice. In 1938, for example, the SEC implemented the so-called “uptick rule,” which generally required that every short sale transaction be entered at a price higher than the price of the previous trade. After extensive review and empirical study, the uptick rule was repealed in 2007.

In response to concerns that short selling may have exacerbated 2008’s market declines, the SEC in April 2009 released [a proposal that contemplated two approaches](#) to restricting short selling. The first approach would establish a market-wide price test for short sales, such as the former uptick rule. The second approach would set up some form of short selling “circuit breaker,” specific only to a particular security and triggered by a severe decline in the price of that security.

ICI Position

ICI does not support any new restriction on short selling at this time. Citing short selling’s “important role in providing market liquidity and price discovery,” ICI urged the SEC to

proceed deliberately in this area. The Institute also noted SEC actions that have already added necessary protections to address abusive short selling; the lack of empirical evidence to indicate that the proposed approaches would have alleviated the markets' recent volatility; the uncertainty of whether the Commission's proposed approaches would increase investor confidence; and the potential unintended consequences.

If the SEC were to adopt new short sale restrictions, ICI recommends that the Commission implement a security-specific circuit-breaker approach, in which an intraday decline in the price of a security from the prior day's close would trigger the "proposed modified uptick rule." The threshold of a 10 percent decline has been proposed by the SEC; the Institute would urge a higher percentage.

Under the proposed modified uptick rule, a trading center would be required to have policies and procedures designed to prevent it from executing or displaying any short sale order—absent an exception—at a price that is below the national best bid for that security. A proposed modified uptick rule triggered by a circuit breaker, ICI said, is the approach "that would have the least impact on legitimate short selling and normal market activity." ICI's comment letter also stated the following:

- ICI recommends that the Commission include appropriate exceptions for any restrictions that it might adopt to ensure the orderly functioning of the securities markets and flexibility in trading, including exceptions for exchange-traded funds, market makers that sell short as part of bona fide market-making and hedging activity, and certain orders executed on a volume-weighted average price basis.
- ICI recommends that any short selling regulations be subject to a robust compliance and enforcement regime to provide investors with confidence that violations or abuses of those regulations will be detected and punished.
- ICI would not support at this time a "pre-borrow" requirement—meaning that short sellers must borrow securities before effecting short sales—without further study of the impact of such a requirement on the securities markets, particularly on borrowing costs and market liquidity.
- ICI encourages the Commission to continue reviewing 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.

Related Links

- [Agenda and Panelists: SEC Roundtable to Examine Short Sale Price Test and Circuit Breaker Restrictions](#)
- [Archived Webcast: Roundtable to Examine Short Sale Price Tests and Circuit Breaker Restrictions](#)
- [National Fund Associations Call for a Sensible Short Selling Regulatory Regime](#)