

COMMENT LETTER

June 23, 2011

ICI Letter on SEC Short Sale Reporting Study (pdf)

June 23, 2011 Ms. Elizabeth M. Murphy Secretary U.S. Securities and Exchange Commission
100 F Street, N.E. Washington, D.C. 20549-1090 Re: Short Sale Reporting Study Required by Dodd-Frank Act Section 417(a)(2) (File No. 4-627) Dear Ms. Murphy: The Investment Company Institute¹ is writing to respond to the Commission's request for comment regarding studies required by the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") on the reporting of short sales.² Specifically, the studies address the feasibility, benefits, and costs of (1) requiring reporting in real time, either publicly or, in the alternative, only to the Commission and the Financial Industry Regulatory Authority ("FINRA"), of short sale positions of publicly listed securities, and (2) conducting a voluntary pilot program in which public companies would agree to have all trades of their shares marked "long," "short," "market maker short," "buy," or "buy-to-cover," and reported as such in real time through the Consolidated Tape.³ Short selling represents a significant portion of the volume of trading that occurs on the securities markets; according to the Release, short selling volume may account for almost half of listed equity share volume. As such, short selling is an integral part of an efficient and effective trading environment, playing an important role in providing market liquidity and price discovery, as well as in investment strategies and risk management activities. Given the importance of short selling to the

¹ The Investment Company Institute is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds (ETFs), and unit investment trusts (UITs). ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. Members of ICI manage total assets of \$13.41 trillion and serve over 90 million shareholders. ² Securities Exchange Act Release No. 64383 (May 3, 2011), 76 FR 26787 (May 9, 2011) ("Release"). The Release notes that the Commission is requesting comment on behalf of its Division of Risk, Strategy, and Financial Innovation. ³ As the Release notes, the term "Consolidated Tape" refers to the current reporting systems for transactions in all exchange-listed stocks and ETFs. Ms. Elizabeth M. Murphy June 23, 2011 Page 2 of 6 markets, the Institute has supported efforts to address issues relating to short selling that may impact the fair and orderly operation of the securities markets and investor confidence in those markets.⁴ At the same time, we believe that any examination of the issues surrounding short selling should be careful and deliberate, balancing the desire to increase transparency with the burdens imposed on market participants by, and the potential unintended consequences of, any new short sale reporting requirements. Most significantly, it is critical that any new regulations should not impede legitimate and lawful short selling. To the extent that new reporting requirements would, for example, deter market

participants from engaging in non-abusive short sales, the benefits of legitimate short selling surely would be reduced. Our comments focus on the impact of requiring the reporting of short sale positions in real time and to the public, particularly at the individual investment manager level. As discussed further below, we believe that increasing transparency of information regarding short sales is a desirable goal. Nevertheless, the potential negative consequences of requiring reporting of investment managers' short sale positions in real time and to the public would outweigh the benefits of such increased reporting. If the Commission determines to require reporting of investment managers' short sale positions, such reporting should be on a sufficiently delayed basis. Our specific comments follow.

Impact on Funds of Short Sale Position Reporting As an initial matter, given the uncertainty over the specific provisions of any new short sale reporting regime, it is difficult to address with certainty the impact on funds of increased short sale position reporting. Of critical importance to funds, and as the Release explains, Section 417 of the Dodd-Frank Act does not address whose positions would be reported, i.e., whether reporting would be at an aggregate security level or at an individual investment manager level. Our most significant concerns with any new reporting regime involve reporting of short sale positions at the investment manager level. If the Commission determines that further reporting of short sale positions is necessary, and it determines that such information should be reported at the investment manager level, we believe it is essential that reporting be required to be made solely to regulators and not to the public.

4 See, e.g., Letters from Paul Schott Stevens, President and CEO, Investment Company Institute, to Christopher Cox, Chairman, Securities and Exchange Commission, dated September 19, 2008 (Short Sale Emergency Orders); Ari Burstein, Senior Counsel, Investment Company Institute, to Florence Harmon, Acting Secretary, Securities and Exchange Commission, dated December 16, 2008 (Short Sale Disclosure); and Heather Traeger, Assistant Counsel, Investment Company Institute, to Florence Harmon, Acting Secretary, Securities and Exchange Commission, dated December 16, 2008 (Rule 204T). Ms. Elizabeth M. Murphy June 23, 2011 Page 3 of 6 Making public the information filed by investment managers in real time may lead to frontrunning of fund trades, adversely impacting the price of the stock that the fund is buying or selling. As we have stated in several letters to the Commission,⁵ the confidentiality of information regarding fund trades is a longstanding concern to Institute members.⁶ Allowing for real time public disclosure of information about investment managers' short sale positions also may confuse investors and other market participants about investment managers' intentions. For example, public disclosure may provide an inaccurate picture of institutional investors' views about the security subject to the reporting. Public disclosure of such information also could result in increased shorting of certain stocks as other market participants imitate firms' publicized short positions. Finally, such a reporting regime could create new opportunities for unfair or otherwise abusive market practices and impair overall investor confidence in the markets. Specifically, the Commission must closely examine who would most likely benefit from real time public disclosure of short sale position data. The Institute believes that real time reporting of short sale position information would not be easily digested by retail investors as well as most institutional investors. Most significantly, we are concerned that this data may be too voluminous to be used promptly by most investors. We therefore believe that the market participants that would be able to react to, and take advantage of, the increased information would be those that have the technological capabilities to do so - the same market participants that raise concerns to funds about the frontrunning of fund orders. We therefore believe that requiring real time public data on short sale positions in this manner could actually damage market quality and liquidity by deterring market participants from affecting short sales if they believe reporting could damage their investments overall by revealing trading

strategies. It is important to note that the Commission considered, and ultimately rejected, requiring institutional investment managers to publicly report short sales and short positions. During the financial crisis in 2008, the Commission issued several emergency orders and an interim final temporary rule to require certain institutional investment managers to file Form SH to report short sales and short

5 See, e.g., Letters from Paul Schott Stevens, President, Investment Company Institute, to Christopher Cox, Chairman, Securities and Exchange Commission, dated September 14, 2005, August 29, 2006, and September 19, 2008. 6 Even if short sale information is required to be provided solely to regulators, regulators must take steps to ensure that this information is protected and kept strictly confidential. For example, we urge the Commission to explain how it intends to respond to requests under the Freedom of Information Act ("FOIA") for information filed about short sale positions within its possession. FOIA Exemption 4 provides an exemption for "trade secrets and commercial or financial information obtained from a person and privileged or confidential." FOIA Exemption 8 provides an exemption for matters that are "contained in or related to examination, operating, or condition reports prepared by, on behalf of, or for the use of an agency responsible for the regulation or supervision of financial institutions." We recommend that the Commission specifically state its intention to exercise its authority to withhold from the public short sale position data under these, or other, relevant exemptions. The need for confidentiality also extends to staff at the Commission and FINRA, and regulators must take steps to ensure that this information is used solely for regulatory purposes. Ms. Elizabeth M. Murphy June 23, 2011 Page 4 of 6 positions in Section 13(f) securities. As we explained in our comment letters on these initiatives, while the Institute strongly supported the Commission's need to obtain information to analyze the effects of its rulemaking relating to short sales and to consider when questions about the propriety of certain short selling occur, any public disclosure of the information submitted under the disclosure requirements would be detrimental to funds.⁷ We do not believe that real time public reporting of investment managers' short sale positions is necessary to achieve the goals of increased short sale position reporting. For example, the Release requests comment whether greater transparency of short positions would help to deter or prevent market abuses related to short selling, or assist in appropriate actions to prevent them. The Institute strongly supports efforts to address potentially abusive or manipulative activities in the securities markets. To the extent market participants are using short selling as a vehicle to illegally manipulate the prices of stocks or in any other abusive manner, those practices must be stopped. However, we do not see how publicly reporting such information in real time, as opposed to solely reporting the information to regulators, would significantly deter from achieving this goal. Similarly, if one of the purposes of short sale reporting is to assist market commentators and others to help the public better understand the securities markets, we do not see the need of requiring such information in real time.⁸ If the Commission ultimately determines that public disclosure of investment manager short sale positions is necessary, we do not see any reason for treating short sale position reporting differently than long position reporting. Therefore, if a public disclosure regime is to be established, we believe it is best achieved by the Commission requiring disclosure of short positions on a periodic, but sufficiently delayed, basis, mirroring the reporting timelines that exist for long positions. Specifically, there could be a standard quarterly reporting requirement for all short sale positions that are above a de minimis threshold similar to the current Form 13F reporting requirements. Such a filing requirement would better balance the Commission's desire for more public disclosure of short sale positions with the impact of such disclosure on institutional investors.⁹

7 The original September 18, 2008 emergency order provided that the information on Form SH would be made publicly available. The Commission amended the emergency order to delay

public disclosure, providing that it would only make the information available to the public two weeks after the due date for the form. The Commission then amended the order once again, this time providing that the information would remain nonpublic to the extent permitted by law. The Commission stated its belief that, "the nonpublic submission of Form SH may help prevent artificial volatility in securities as well as further downward swings that are caused by short selling, while at the same time, providing the Commission with useful information to combat market manipulation that threatens investors and capital markets. Also, the Commission...is concerned that publicly available Form SH data could give rise to additional, imitative short selling that was not intended by the Commission's order." The Commission ultimately let expire interim final temporary Rule 10a-3T that required reporting by investment managers of short sale positions. 8 If the Commission determines to require short sale reporting at the individual investment manager level, we support the establishment of a significant reporting threshold that, as the Release notes, would limit short sale reporting requirements to holders of only significant net short positions. 9 While short sale position reporting on an aggregate, security by security basis would alleviate some of the concerns relating to reporting short sale positions on an investment manager level, we believe reporting on an aggregate basis still could Ms. Elizabeth M. Murphy June 23, 2011 Page 5 of 6 Real Time Transaction Reporting on the Consolidated Tape Many of the concerns discussed above with respect to the reporting of short sale positions are equally applicable to marking the Consolidated Tape, particularly reporting of marked trades in real time. These concerns include the potential for facilitating the frontrunning of fund trades, questions about who would be able to take advantage of the increased information from marking, the usefulness of such information in real time to most investors, and the usefulness of this information in real time to provide market commentators with information to better understand the operation of the securities markets. Additional concerns are raised if the information reported on the Consolidated Tape is not accurate and error-free. If the Consolidated Tape marks were not completely reliable, this could present possibilities for misinterpretation of the data by investors that could take away from any benefits presented by short sale marking. The study also only addresses the feasibility, benefits and costs of conducting a voluntary, pilot program to marking the Consolidated Tape. The Institute does not object to conducting the program on a pilot basis. We believe, however, that such a pilot must be conducted in a manner that produces valuable and reliable empirical evidence on the costs and benefits of marking. To this end, we question the benefits of conducting a pilot program purely on a voluntary basis and the usefulness of any data derived from such a pilot. Conducting a pilot in this manner could create a limited database of information, depending on which issuers choose to participate, and could inhibit comparisons of trading in pilot companies and non-pilot companies. The Institute believes a pilot must include a range of issuers, including large, medium, and small cap issuers, chosen by the Commission to maximize the production of useful, empirical data. Create Consistency with Short Sale Reporting in Other Jurisdictions As the Release recognizes, regulators in several foreign jurisdictions have adopted rules requiring disclosure of short sales and short positions. At the moment, however, these rules are not consistent and in many jurisdictions, the rules' provisions, particularly those relating to public disclosure of investment managers' short sales and short positions, generate significant concerns relating to frontrunning, as well as create operational and cost burdens. As the Commission examines its current, and considers further, initiatives relating to short sales in the United States, we urge it to work closely with foreign regulators to create consistent and sensible cross-border regulations in this area. Our increasingly global markets demand such cooperation among

present concerns, as outlined above, for investment

managers, particularly for the reporting of short sale positions in small cap and mid cap securities. We note that Section 929X(a) of the Dodd-Frank Act amended Section 13(f) of the Securities Exchange Act of 1934 to require the Commission to address short sale disclosure by adopting rules requiring monthly (or potentially more frequent) public short sale disclosures by security, including the “aggregate amount of the number of short sales of each security, and any additional information determined by the Commission.” Ms. Elizabeth M. Murphy June 23, 2011 Page 6 of 6 national regulators to avoid negative consequences of incongruent regulatory requirements and to encourage regulatory synergies as funds pursue an increasing cross-border presence in the interest of shareholders.¹⁰ * * * * * If you have any questions on our comment letter, please feel free to contact me directly at (202) 326-5815, or Ari Burstein at (202) 371-5408. Sincerely, /s/ Karrie McMillan Karrie McMillan General Counsel cc: The Honorable Mary L. Schapiro The Honorable Kathleen L. Casey The Honorable Elisse B. Walter The Honorable Luis A. Aguilar The Honorable Troy A. Paredes Craig M. Lewis, Director Amy Edwards, Assistant Director Division of Risk, Strategy and Financial Innovation Robert W. Cook, Director James Brigagliano, Associate Director Division of Trading and Markets Eileen Rominger, Director Division of Investment Management U.S. Securities and Exchange Commission

10 See Industry Statement from Investment Company Institute, Investment Management Association (UK) and the Investment and Financial Services Association (Australia), dated January 6, 2009 (available at http://www.ici.org/policy/current_issues/09_news_short_selling).