

COMMENT LETTER

June 19, 2009

ICI Comment Letter on SEC Short Sale Regulation Proposal

June 19, 2009 Ms. Elizabeth M. Murphy Secretary Securities and Exchange Commission 100 F Street, N.E. Washington, D.C. 20549 Re: Amendments to Regulation SHO (File No. S7-08-09) Dear Ms. Murphy: The Investment Company Institute¹ is pleased to comment on the Securities and Exchange Commission's proposed amendments to Regulation SHO under the Securities Exchange Act of 1934.² An efficient and effective trading environment is critical to Institute members and the over 93 million shareholders they serve.³ The Institute therefore has supported the Commission's continuing 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

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 \$10.18 trillion and serve over 93 million shareholders. ² SEC Release No. 34-59748 (April 10, 2009), 74 FR 18042 (April 20, 2009) ("Release"). ³ As of year-end 2008, registered investment companies held 27% of outstanding U.S. issued stock, 44% of outstanding commercial paper, 33% of tax-exempt debt, 9% of U.S. corporate and foreign bonds and 15% of U.S. Treasury and government agency debt. See 2009 Investment Company Fact Book, 49th Edition, p. 11. ⁴ See, e.g., Letters from Ari Burstein, Associate Counsel, Investment Company Institute, to Jonathan G. Katz, Secretary, Securities and Exchange Commission, dated January 5, 2004 ("2004 ICI Letter"); Paul Schott Stevens, President and CEO, Investment Company Institute, to Christopher Cox, Chairman, Securities and Exchange Commission, dated September 19, 2008; Ari Burstein, Senior Counsel, Investment Company Institute, to Florence Harmon, Acting Secretary, Securities and Exchange Commission, dated December 16, 2008 ("2008 ICI Short Sale Disclosure Letter"); and Heather Traeger, Assistant Counsel, Investment Company Institute, to Florence Harmon, Acting Secretary, Securities and Exchange Commission, dated December 16, 2008 ("2008 ICI Rule 204T Letter"). See also Statement of Kevin Cronin, Invesco, at the SEC Roundtable on Short Sale Restrictions, May 5, 2009 (expressing the Institute's preliminary views on the Commission's proposals). Ms. Elizabeth M. Murphy June 19, 2009 Page 2 of 12 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 designed to enhance fund performance and maximize returns to investors. For this reason, legitimate and lawful short selling must be allowed to continue.

We recognize, however, the Commission's concern about the impact on investor confidence of recent market events and the resulting need to re-evaluate the need for some form of restriction on short selling. We therefore support a careful and deliberate examination of the issues surrounding short sales, which balances the Commission's obligation to protect the markets from abusive short selling with the burdens imposed on market participants by, and the potential unintended consequences of, any short sale restrictions.⁵

I. Summary of Recommendations

- We do not support at this time any new restrictions on short selling. Commission actions have already added necessary protections to address abusive short selling; empirical evidence is lacking that any of the proposed approaches would have alleviated any of the markets' recent volatility; as the Commission itself has acknowledged, there is uncertainty whether any of the proposed approaches would increase investor confidence in the markets; and there are potential unintended consequences of any new restrictions.
- If the Commission nevertheless determines that some form of new short sale restriction is necessary, we would support a circuit breaker that triggers the "proposed modified uptick rule" as the approach that would have the least impact on legitimate short selling and normal market activity.
- We recommend 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.
- We recommend 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.

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Earlier this year, the Institute issued a joint statement with the Investment Management Association (UK) and the Investment and Financial Services Association (Australia) to reaffirm the support of prudent regulatory oversight of short selling and recommend a sensible global response to regulatory reform in this area. See Industry Statement from ICI (USA), IMA (UK) and IFSA (Australia), dated January 6, 2009 (available at http://www.ici.org/policy/current_issues/09_news_short_selling). In addition, the Institute filed a letter with IOSCO on its Consultation Report addressing several proposed principles for the effective global regulation of short selling. See Letter from Ari Burstein, Senior Counsel, Investment Company Institute, to Greg Tanzer, Secretary General, IOSCO, dated May 18, 2009. Ms. Elizabeth M. Murphy June 19, 2009 Page 3 of 12

- We would not support at this time a restriction on short selling based on a mandatory pre-borrow requirement without further study of the impact of such a requirement on the securities markets, particularly on borrowing costs and market liquidity.
- We encourage 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.

II. Proposed Approaches to Restrictions on Short Selling

The Release proposes several approaches to restrictions on short selling. One approach would apply a price test on a market wide and permanent basis. With respect to this approach, the Commission proposes two alternative price tests. The first would be based on the national best bid ("proposed modified uptick rule") while the second would be based on the last sale price ("proposed uptick rule"). The other approach would operate through circuit breakers and would apply only to a particular security during a specified market decline in that security. With respect to this approach, the Commission proposes two alternatives. The first would include a circuit breaker rule that, when triggered by a specified price decline in a particular security, would temporarily prohibit any person from selling short that security, subject to certain exceptions ("proposed circuit breaker halt rule"). The second would consist of a circuit breaker rule that, when triggered by a specified price decline in a particular security, would implement, on a temporary basis, one of the two proposed price

tests discussed above.⁶ A. New Short Sale Restrictions are Not Warranted At this Time Short selling, as with any other type of trading, should be subject to appropriate controls to minimize the potential risks it could have on the orderly and efficient functioning and stability of the securities markets. In considering any new restrictions, the Commission faces a difficult dilemma. Actions that the Commission has already taken appear to have added necessary protections to the markets and to have addressed concerns relating to abusive short selling. It also is unclear from available empirical data whether any of the proposed approaches would have increased investor confidence or alleviated any of the unprecedented market conditions experienced over the past 18 months. In addition, the unintended consequences of any new restrictions on short selling are uncertain. At this time, therefore, new restrictions on short sales are not warranted and the Commission should continue to rely on current short sale regulations and the anti-fraud and anti-manipulation provisions of the securities laws to address potentially abusive short selling.

⁶ Under the proposed rules, all covered securities, wherever traded, would be subject to the same short sale restrictions. We support the uniform application of short sale restrictions in covered securities across all markets. Most significantly, uniformity would prevent investor confusion as to the applicability of a short sale restriction to a particular security depending on where that security was traded. Ms. Elizabeth M. Murphy June 19, 2009 Page 4 of 12 Our views represent a consensus, but we also acknowledge that some fund groups believe that the Commission should adopt some form of short sale price restriction, namely the proposed modified uptick rule, on a permanent basis to address the Commission's concerns. All members agree, however, that regardless of what action the Commission takes, it must be careful to ensure that it does not negatively impact investors by, for example, reducing market liquidity or harming price discovery. 1. Commission Actions Have Added Necessary Protections to Address Abusive Short Selling As the Release notes, in response to concerns about the role that short selling, and in particular potentially abusive short selling, may have in connection with recent price fluctuations in the securities markets, the Commission has taken a number of actions aimed at addressing these concerns. Most significantly, the Commission adopted an interim final temporary rule inhibiting abusive "naked" short selling through the requirement that securities be purchased or borrowed to close out any fail to deliver position;⁷ a "naked" short selling anti-fraud rule;⁸ and an interim final temporary rule requiring institutional investment managers to report to the Commission certain information concerning their short sales and short positions.⁹ The Institute supported these actions.¹⁰ As discussed further below, these actions have made great strides towards addressing abusive short selling, particularly in efforts to reduce fails to deliver. Given the restrictions and requirements that these actions have added to protect investors, and the markets in general, from concerns relating to short selling, and the effectiveness of these actions, we do not support further rulemaking that may prove to not provide any benefits to the markets and, in turn, that may have uncertain effects on the markets. 2. Empirical Evidence Does Not Support New Restrictions Since the elimination in 2007 of short sale price test restrictions, there have been numerous studies, including those by the Commission, examining the impact on the securities markets of the elimination.¹¹ Many of these studies found no detrimental impact on the markets. In addition, data

⁷ Amendments to Regulation SHO, SEC Release No. 34-58773 (October 14, 2008), 73 FR 61706 (October 17, 2008). ⁸ "Naked" Short Selling Antifraud Rule, SEC Release No. 34-58774 (October 14, 2008), 73 FR 61666 (October 17, 2008). ⁹ Disclosure of Short Sales and Short Positions by Institutional Investment Managers, SEC Release No. 34-58785 (October 15, 2008), 73 FR 61678 (October 17, 2008). ¹⁰ See 2008 ICI Short Sale Disclosure Letter and 2008 ICI Rule 204T Letter, *supra* note 4. ¹¹ See Analysis of a Short Sale Price Test using Intraday Quote and Trade Data, Office of Economic

Analysis, Securities and Exchange Commission, December 17, 2008 and Analysis of Short Selling Activity during the First Weeks of September, 2008, Office of Economic Analysis, Securities and Exchange Commission, December 16, 2008. See also Unshackling Short Sellers: The Repeal of the Uptick Rule, Ekkehart Boehmer, Mays Business School, Texas A&M University, Charles M. Jones, Ms. Elizabeth M. Murphy June 19, 2009 Page 5 of 12 gathered during the Commission's pilot program temporarily suspending the short sale price restrictions and the Commission's Office of Economic Analysis's ("OEA") related report generally supported removal of the restrictions.¹² In particular, the OEA report found little empirical justification for maintaining short sale price test restrictions, that short sale price tests did not have a significant impact on daily volatility, and that realized liquidity levels were unaffected by the removal of short sale price test restrictions.¹³

3. Potential Unintended Consequences of New Restrictions We also are concerned about potential unintended consequences of any new restrictions on short selling. As the Release notes, to the extent that the proposed short sale restrictions would result in increased costs to short selling, it may lessen some of the benefits of legitimate short selling. Additionally, the new restrictions could decrease market efficiency and price discovery, and result in a less efficient allocation of capital, an increase in trading costs, and a decrease in liquidity. None of these outcomes would benefit investors. Thus, the potential costs associated with the proposed short sale price tests may outweigh any potential benefits of the new restrictions.

B. If the Commission Determines New Restrictions are Necessary, a Circuit Breaker Modified Uptick Rule Would be Least Damaging to the Markets If the Commission nevertheless determines that it must impose one of the proposed restrictions, a circuit breaker triggering the proposed modified uptick rule would be the least damaging solution for the markets.

1. Circuit Breaker Triggering Modified Uptick Rule The proposed circuit breaker modified uptick rule would, once triggered by a 10% decline in the price of a security from the prior day's closing price,¹⁴ impose the modified uptick rule in the

Columbia Business School, and Xiaoyan Zhang, Johnson Graduate School of Management, Cornell University, December 11, 2008 and It's ShoTime! Short-Sale Price-Tests and Market Quality, Fischer College of Business Working Paper No. 2007- 03-002, Karl B. Diether, Ohio State University, Kuan-Hui Lee, Rutgers Business School at Newark & New Brunswick and Korea University Business School, and Ingrid M. Werner, Fisher College of Business, The Ohio State University, August 14, 2007. ¹² Economic Analysis of the Short Sale Price Restrictions under the Regulation SHO Pilot, Office of Economic Analysis, Securities and Exchange Commission, February 6, 2007 ("OEA report"). ¹³ At the same time, the OEA report found some evidence that short sale price tests dampened intraday volatility for smaller stocks and that price test restrictions resulted in an increase in quote depths. ¹⁴ As proposed, the circuit breaker price test rules would be triggered by a 10% intraday decline in the price of an individual security from the prior day's closing price as reported in the consolidated system. We would urge the Commission to consider a circuit breaker that would be initiated after a greater percentage decline from the prior day's close. A threshold based on a greater percentage decline would be more consistent with the Commission's goals, i.e., creating a rule based on a "severe" price decline in a particular security. Ms. Elizabeth M. Murphy June 19, 2009 Page 6 of 12 individual security at times when the national best bid is calculated and disseminated in the consolidated system, for the remainder of the trading day.¹⁵ The circuit breaker triggering the modified uptick rule would have several advantages over the other proposed approaches. Most significantly, this alternative is more narrowly tailored than a permanent, market-wide short sale price test restriction, focusing on a particular security experiencing significant downward pressure on its stock price. In addition, for the reasons discussed below, the modified uptick rule in general has several advantages over the proposed uptick

rule. Of the proposed circuit breaker price tests, we therefore believe the circuit breaker triggering the modified uptick rule would be preferable than one that triggers the proposed uptick rule. Finally, as the Release notes, allowing short selling to continue through a price test restriction once a circuit breaker is triggered might have a lesser impact on legitimate short selling and normal market activity than a circuit breaker that triggers a short selling halt that would temporarily prohibit any short selling in that security.¹⁶

2. Other Proposed Restrictions and Circuit Breakers Of the other proposed approaches, a price test based on the national best bid (i.e., the proposed modified uptick rule) has advantages over a test based on the last sale price (i.e., the proposed uptick rule) in today's markets. As the Release discusses, bids generally are a more accurate reflection of current prices for a security than last sale prices due, among other things, to delays that can occur in the reporting of last sale price information and the manner in which last sale price information is published to the markets. As a result, the proposed uptick rule would be more difficult to implement. We also would not support an approach that would halt short selling in a particular security. We therefore believe the proposed circuit breaker halt rule would not be an appropriate response to the Commission's goal of addressing abusive short selling or restoring investor confidence in the markets. The Release discusses several potential costs associated with this approach. Specifically, this approach could restrict otherwise legitimate short selling activity during periods of extreme volatility and

15 The Release states that to avoid market disruption that may occur if a circuit breaker is triggered late in the trading day, the proposed circuit breaker rules would not be triggered if the specified market decline threshold is reached within thirty minutes of the end of regular trading hours. The Institute supports such a condition. Given the recent volatility at the end of the trading day and the importance of an efficient and uninterrupted close to our members, the close should not be inhibited by a price test that would be triggered so close to the end of the trading day. In addition, the proposed time period that the price restriction, when triggered, would be in place is appropriate, i.e., the remainder of the trading day, and we do not believe that the price restriction should be in place for any longer period of time. 16 We recognize that a circuit breaker modified uptick rule would result in certain costs for market participants responsible for implementing the rule and assuring compliance with its requirements, which may be greater than the costs associated with some of the other approaches, i.e., the circuit breaker short selling halt rule. We are sensitive to the costs associated with the proposed approaches; in our view, however, the benefits of the circuit breaker modified uptick rule in mitigating unintended consequences outweigh those costs. Ms. Elizabeth M. Murphy June 19, 2009 Page 7 of 12 therefore inhibit price discovery and the provision of liquidity to the market.¹⁷ In addition, the emergency short sale ban implemented last fall on the publicly traded securities of certain financial institutions¹⁸ did not improve confidence in the markets or prevent the prices of those particular stocks from declining. In fact, preliminary studies have shown that the short sale ban reduced liquidity and increased volatility in the markets.¹⁹

C. Other Issues Relating to Proposed Short Sale Restrictions The Commission should evaluate other issues prior to implementing new short selling restrictions. These include appropriate exceptions and the need for an effective enforcement and compliance regime. 1. Appropriate Exceptions If the Commission determines to adopt some form of restrictions on short selling, we support appropriate exceptions to ensure that the restrictions allow for the orderly functioning of the securities markets and flexibility in trading. As the Release discusses, the proposed approaches would contain many of the exceptions contained in the former short sale price tests. Similar exceptions would be of critical importance to the operation of the proposed rules. Such exceptions allow for flexibility by market participants in short selling activities that are critical to the efficient functioning of capital markets and would lessen the impact of the

proposed short sale restrictions on market liquidity, efficiency and price discovery. The specific approach, if any, that the Commission determines to adopt will drive the accompanying exceptions. For example, an approach that is permanent and full-time (e.g., the modified uptick rule) may necessitate more exceptions than one triggered by a temporary circuit breaker. Similarly, a circuit breaker short sale ban may necessitate more or different exceptions than a circuit breaker that still permits short selling to occur. While we do not have comments on all the proposed exceptions, there are several that directly impact our members.

17 The Release also discusses concerns regarding a potential “magnet effect” that could arise as an unintended consequence of a halt in short selling, as short sellers rush to execute short sales before the circuit breaker is triggered, driving down the price of an equity security. There have been differing views expressed on whether such a magnet effect would occur; if the Commission determines to implement the circuit breaker short sale ban, it should therefore monitor the impact of such an effect. 18 See SEC Release No. 34-58592 (September 18, 2008), 73 FR 55169 (September 24, 2008). 19 See, e.g., The Undesirable Effects of Banning Short Sales, Abraham Lioui, EDHEC Risk and Asset Management Research Centre, April 2009; Impact of Shorting Restrictions on Portfolio Efficiency, MSCI Barra Research, October 2008; and Shorting Financial Stocks Should Resume, The Wall Street Journal, Arturo Bris, IMD, Yale International Center for Finance, and European Corporate Governance Institute, September 29, 2008. Ms. Elizabeth M. Murphy June 19, 2009 Page 8 of 12 a. Exception for Exchange Traded Funds The Release requests comment whether the proposed restrictions should include an exception for transactions in exchange traded funds (“ETFs”) similar to the exception for ETFs under the prior price tests. As the Release notes, the Commission previously exempted ETFs from short sale price tests, subject to various conditions, because it found that trading in ETFs would not be susceptible to the practices that the restrictions were designed to prevent. The Institute strongly supports an exception for ETFs from any restriction the Commission determines to implement. We believe the same reasoning applied by the Commission under the former price tests continues to be applicable today – it is unlikely that the market price of a particular stock would be manipulated downward by unrestricted short selling in an ETF. Given the unique structure and operation of ETFs, we also urge the Commission to reconsider the necessity of imposing conditions on ETFs to obtain exemptive relief. If the Commission determines that conditions are necessary, however, we recommend that the Commission update those conditions to reflect the current structure and composition of ETFs²⁰ and conform the conditions to the listing standards imposed by the securities exchanges on ETFs to ensure consistency among rules and regulations applicable to these products. b. Market Maker Exception The Release requests comment whether, in connection with the proposed restrictions, to include an exception for market makers that sell short as part of bona fide market making and hedging activity in derivative securities based on covered securities, or ETFs of which covered securities are a component. We support such an exception as it would continue to permit market makers to provide necessary liquidity to these products. c. VWAP Exception The Release provides an exception for certain orders executed on a volume-weighted average price (“VWAP”) basis. It also requests comment on whether the exception should be limited to VWAP transactions or should be a broader “benchmark” exception, providing relief from the proposed rule in connection with “any short sale at a price that is not based, directly or indirectly, on the quoted price of the covered security at the time of execution and for which the material terms were not reasonably determinable at the time the commitment to execute the order was made.”

20 The Commission’s Division of Trading and Markets has modified the prior conditions to exemptive relief through a series of no-action letters. See, e.g., Letter from James A. Brigagliano, Associate Director, Division of Market

Regulation, Securities and Exchange Commission, to Benjamin Haskin, Esq., Willkie Farr & Gallagher LLP, dated April 8, 2007 and Letter from James A. Brigagliano, Acting Associate Director, Division of Market Regulation, Securities and Exchange Commission, to Stuart M. Strauss, Esq., Clifford Chance US LLP, dated October 24, 2006. Ms. Elizabeth M. Murphy June 19, 2009 Page 9 of 12 The Institute supports broadening the exception to include the above language. We believe that such a change is necessary to facilitate the execution of the types of large orders executed by institutional investors. Customers entering into unconditional contracts to purchase securities at a specified price benchmark do not raise the type of manipulative concerns or facilitate the type of market effects that short sale restrictions would be designed to prevent. Failure to provide an exception, however, could act as a disincentive for broker-dealers to provide liquidity in handling, for example, customer block orders for fear of violating the proposed restrictions. 2. Robust Compliance and Enforcement Regime A robust compliance and enforcement regime attached to any new short sale regulations is critical to provide investors with confidence that violations or abuses of those regulations will be detected and punished. Our members report that such a regime was lacking under the prior short sale price restrictions. The proposals would require trading centers to, among other things, regularly surveil to ascertain the effectiveness of any policies and procedures required to be adopted under the proposed rules and promptly take action to remedy detected deficiencies. Similarly, a trading center or broker-dealer would need to take such steps as would be necessary to enable it to enforce its policies and procedures effectively. We support these requirements and encourage the Commission to examine other ways to ensure that any new restrictions will be enforced. III. Settlement of Short Selling Transactions and Pre-Borrowing Requirements An effective discipline for the settlement of short selling transactions is an important component of a short selling regulatory regime and may help restore investor confidence in the markets, perhaps more than the proposed short sale price restrictions. The Institute therefore has strongly supported Commission efforts in this area. Most significantly, we supported the Commission's interim final rule that inhibits abusive "naked" short selling through a requirement that securities be purchased or borrowed to close out any fail to deliver position.²¹ By all accounts, the Commission's rule has made

21 See 2008 ICI Rule 204T Letter, *supra* note 4.

Specifically, the interim final rule provides that sellers of equity securities and their broker-dealers deliver securities by the close of business on settlement date, i.e., T+3. Fail to deliver positions must be closed out no later than the beginning of regular trading hours on the settlement day following the day the fail to deliver position occurs. Broker-dealers in violation of this "close-out" requirement are prohibited from further short sales in the same security unless the shares are located and pre-borrowed. Rule 204T provides a limited exception from the close-out requirement for fail to deliver positions resulting from long sales of equity securities. Specifically, a broker-dealer that can demonstrate that a fail to deliver position resulted from a long sale will have until the beginning of regular trading hours on the third consecutive settlement day following the settlement date to close out the fail to deliver position by purchasing securities of like kind and quantity, i.e., T+6. Ms. Elizabeth M. Murphy June 19, 2009 Page 10 of 12 great strides in this area, particularly in efforts to reduce fails to deliver.²² A. Feasibility of Short Sale Restrictions Based on Pre-Borrowing Requirements There recently have been suggestions that concerns relating to short sales could be addressed through a continued tightening of requirements relating to the close out of fails to deliver, i.e., through some form of pre-borrowing requirement. For example, the U.S. Government Accountability Office ("GAO") recently issued a report examining the impact of Regulation SHO on fails to deliver.²³ The GAO Report found that some market participants believe that the stricter close-out requirements adopted by the Commission through the interim final rule do not prevent manipulative trading from

occurring within the current 3-day settlement period. These market participants recommended that the Commission therefore require all short sellers to pre-borrow securities before a short sale to address market manipulation related to naked short selling. While such an approach has potential benefits, it also has several potential costs, including increased borrowing costs and a reduction in liquidity. In addition, there is no empirical evidence that a pre-borrow requirement would improve market quality. For example, while the GAO Report observed significant declines in threshold securities and fails to deliver after the Commission implemented its emergency orders in the fall,²⁴ it noted that the sustainability of this trend is unclear. Absent further study on the potential impact of a pre-borrow requirement on the securities markets, the Institute does not support a restriction on short selling that would be based on a pre-borrow requirement, whether such a restriction would be implemented through a permanent restriction or through a temporary circuit breaker.

B. Impact on Securities Lending In our comment letter on the Commission's interim final rule, we discussed the effect of the rule on the securities lending market.²⁵ For example, despite efforts in the rule to clarify issues relating to the close out of a fail to deliver position for a long sale of equity securities, we noted that the timing and close-out requirements of the rule have the potential to create disincentives for holders of long positions to lend their securities. Among other reasons, investment managers may be disinclined to

22 See, e.g., Memorandum from the Office of Economic Analysis regarding Impact of Recent SHO Rule Changes on Fails to Deliver, Securities and Exchange Commission, April 16, 2009. 23 "Regulation SHO: Recent Actions Appear to Have Initially Reduced Failures to Deliver, but More Industry Guidance is Needed," United States Government Accountability Office, May 2009 (GAO-09-483) ("GAO Report"). 24 See SEC Release Nos. 34-58572 (September 17, 2008), 73 FR 54875 (September 23, 2008) ("September Emergency Order") and 34-58166 (July 15, 2008), 73 FR 42379 (July 21, 2008). 25 See 2008 ICI Rule 204T Letter, *supra* note 4. Ms. Elizabeth M. Murphy June 19, 2009 Page 11 of 12 loan securities if there is a risk that the manager will be exposed to frequent buy-ins, the portfolio manager will be unable to sell the loaned security when it chooses without the sale being treated as a short sale (because of an untimely recall notice), or the counterparty risk for timely return of a lent security is high, exposing the lender to regulatory penalties. Accordingly, we urged the Commission to consider whether modifications could be made to the rule to address this concern. Since the implementation of the interim final rule, many have claimed that the concerns described above have come to fruition. For example, according to the GAO Report, some industry comment letters and officials explained that some broker-dealers are closing out all fail to delivers on T+4 (two days earlier than required), regardless of whether they are the result of a long or short sale, increasing securities lenders' risk of being bought-in and causing some lenders to exit or reduce their participation in the market. In addition, the GAO Report states that industry officials said that the stricter close-out requirements imposed through the Commission's September Emergency Order and the interim final rule have increased market volatility and price spikes at the market open and resulted in instability in the securities lending market. Industry officials also said that the new close-out requirements are having a negative impact on the efficient operation of the securities lending market, leading potentially to reduced inventory of shares available for borrowing, thereby increasing borrowing costs and reducing liquidity. In light of these concerns, we encourage the Commission to continue to review fully the implications of rules in this area on securities lending and to address any unintended consequences for, or impediments to, the effective operation of the securities lending markets. * * * * * We look forward to working with the Commission as it continues to examine these issues. In the meantime, if you have any questions, please feel free to contact me directly at (202) 326-5815, Ari Burstein at (202) 371-5408 or Heather Traeger at (202) 326-5920. Sincerely, /s/ Karrie

McMillan Karrie McMillan General Counsel Ms. Elizabeth M. Murphy June 19, 2009 Page 12 of 12 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 James Brigagliano, Acting Co-Director Dan Gallagher, Acting Co-Director Division of Trading and Markets Andrew "Buddy" Donohue, Director Division of Investment Management U.S. Securities and Exchange Commission

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