



December 15, 2008

Via Electronic Mail: rule-comments@sec.gov

Florence E. Harmon
Acting Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: File No. S7-31-08; Disclosure of Short Sales and Short Positions by Institutional Investment Managers

Dear Ms. Harmon:

Managed Funds Association (“MFA”)¹ welcomes the opportunity to comment on Rule 10a-3T, the interim final temporary rule requiring institutional investment managers to report short sales and short positions to the Commission on Form SH (the “Rule”). MFA and its members share the Securities and Exchange Commission’s (the “SEC” or the “Commission”) deep concerns about the crisis in the global financial markets and strongly support efforts to prevent, detect and punish manipulative conduct.

Over a two-month period, the SEC took a series of emergency actions in response to turbulent market conditions and its concern over potentially manipulative short selling activity. The Commission’s first action taken during this period was its announcement on July 13, 2008 that it would immediately conduct examinations “aimed at the prevention of the intentional spread of false information intended to manipulate securities prices.”² Shortly thereafter, on July 15, 2008, the SEC issued an Emergency Order requiring an investor engaging in a short sale of certain financial firms to borrow, arrange to borrow, or have the security available to borrow in its inventory prior to effecting a short sale.³ The July 15th Order was effective from July 21, 2008 until August 12, 2008.

¹ MFA is the voice of the global alternative investment industry. Its members are professionals in hedge funds, funds of funds and managed futures funds, as well as industry service providers. Established in 1991, MFA is the primary source of information for policy makers and the media and the leading advocate for sound business practices and industry growth. MFA members include the vast majority of the largest hedge fund groups in the world who manage a substantial portion of the approximately \$1.5 trillion invested in absolute return strategies. MFA is headquartered in Washington, D.C., with an office in New York.

² Securities Regulators to Examine Industry Controls Against Manipulation of Securities Prices Through Intentionally Spreading False Information, SEC Release 2008-140 (July 13, 2008).

³ Emergency Order Pursuant to Section 12(k)(2) of the Securities Exchange Act of 1934 Taking Temporary Action to Respond to Market Developments, SEC Release No. 34-58166 (July 15, 2008), 73 FR 42379 (July 21, 2008) (“July 15th Order”). The Commission amended this Order in SEC Release No. 34-58190 (July 18, 2008), 73 FR 42837 (July 23, 2008) (Taking Temporary Action to Respond to Market Developments).

In late September, during a period of continued fluctuations in securities prices, the SEC issued further restrictions on short selling. On September 17th, the SEC issued an Emergency Order:

- (i) imposing a penalty on any participant of a registered clearing agency and any broker-dealer from which it receives trades for clearance and settlement, for having a fail to deliver position at a registered clearing agency in any equity security;
- (ii) eliminating the options market maker exception from the close-out requirement of Regulation SHO; and
- (iii) adopting a “naked” short selling antifraud rule.

The SEC said that it intended its actions to “impose powerful disincentives to those who might otherwise exacerbate artificial price movements through ‘naked’ short selling.”⁴

On September 18th, in response to market conditions, the SEC issued three additional Emergency Orders. First, the SEC eased restrictions in Rule 10b-18 of the Securities Exchange Act of 1934 (the “Exchange Act”) to provide increased certainty for issuers to repurchase their own securities.⁵ Second, the SEC issued a sweeping prohibition on short sales in the publicly traded securities of 799 financial firms.⁶ Third, the SEC set out the precursor to Rule 10a-3T, mandating that certain institutional investment managers⁷ report daily short sales and short positions on new Form SH (the “Disclosure Order”).⁸ Following the expiration of the Disclosure Order, the SEC adopted Rule 10a-3T as an interim final temporary rule.

The SEC issued the Emergency Orders described above (together, the “Emergency Orders”) and Rule 10a-3T at a time of rapidly changing market conditions without a period of notice and comment and with limited discussion between regulators and market participants. During its consideration of the Rule, we strongly encourage the Commission to examine whether the Emergency Orders have been effective in achieving the stated goal of preventing artificial price movements due to “naked” short selling. We also respectfully suggest that the SEC should communicate to the public the results of its recent examinations of potential manipulation of securities prices through spreading of false information, and disclose whether the examination and the information reported on Form SH revealed instances of manipulative “naked” short selling or

⁴ Emergency Order to Enhance Investor Protections Against Naked Short Selling, SEC Release No. 34-58572 (Sept. 17, 2008), 73 FR 54875 (Sept. 23, 2008).

⁵ SEC Order Easing Restrictions on Issuers to Re-Purchase Their Securities, SEC Release No. 34-58588 (Sept. 18, 2008), 73 FR 55174 (Sept. 24, 2008).

⁶ SEC Order Halting Short Selling in Financial Stocks, SEC Release No. 34-58592 (Sept. 18, 2008), 73 FR 55169 (Sept. 24, 2008). The SEC later amended the Order to prohibit short sales in the securities of additional firms, such as IBM.

⁷ See *infra* note 13.

⁸ SEC Order Halting Short Selling in Financial Stocks, SEC Release No. 34-58591 (Sept. 18, 2008), 73 FR 55175 (Sept. 24, 2008). See also Amendment to SEC Order Requiring Institutional Money Managers to Report New Short Sales, SEC Release No. 34-58591A (Sept. 21, 2008), 73 FR 55557 (Sept. 25, 2008).

other related market abuses.⁹ In addition, the SEC should examine and disclose its findings as to any adverse consequences of the Orders and Rule 10a-3T to the capital markets, including effects as to market efficiency, liquidity and price discovery.¹⁰ The Commission should base any further rulemaking on the results of this review and other relevant facts.

If the SEC deems it necessary to require reporting of short sale information, we propose the Commission require prime brokers and clearing brokers, rather than individual institutional investors, to report short sale and short position information. For the reasons discussed below, MFA believes that such a reporting regime would provide the SEC with more comprehensive market information with respect to short selling and better enable the SEC to respond to any potential manipulation in the securities markets caused by short selling.

In the alternative, we suggest modifications to the Rule designed to provide the SEC with more useful short sale information while mitigating undue burdens to individual investors. Specifically, we recommend that an amended Rule, among other things:

- Adopt reporting based upon positions and not include additional trade reporting. Eliminating trade reporting will reduce the current burden and cost investors bear in having to have systems to track both positions and trades. End of day positions should be reportable.
- Eliminate the \$10,000,000 fair market value *de minimis* threshold. A single, percentage based threshold would simplify reporting and be consistent with the Commission's objectives and reporting rules adopted by most foreign jurisdictions.
- Reduce the frequency of filing Form SH from weekly to quarterly to reduce reporting costs and technological burdens imposed on investors.
- Increase the 0.25% *de minimis* threshold to 2.0%. Short sales and short positions below 2.0% are not significant and institutional investors should not have to report that information on Form SH.
- **Continue to require that reporting to the Commission be non-public.** Public disclosure of information on Form SH would likely result in adverse consequences to investors, issuers and other market participants.

I. REPORTING BY PRIME BROKERS AND CLEARING BROKERS

We believe reporting by prime brokers and clearing brokers, rather than individual investors, would better achieve the policy concerns the Commission articulated in its release

⁹ As noted below, MFA strongly urges the Commission to keep confidential the specific information that institutional investors report on Form SH. We suggest that the Commission share its general findings based on a review of those data and other information.

¹⁰ See also MFA's recommendation for the Commission to review the effects of Rule 204T in letter from Stuart J. Kaswell, Executive Vice President and General Counsel, Managed Funds Association, to Florence E. Harmon, Acting Secretary, Securities and Exchange Commission, dated Dec. 15, 2008.

adopting Rule 10a-3T (the “Release”),¹¹ and the Emergency Orders. As described in the Release, the Commission is concerned with the “substantial threat of sudden and excessive fluctuations of securities prices and disruption in the functioning of the securities markets that could threaten fair and orderly markets” and “unnecessary or artificial price movements that may be based on unfounded rumors and may be exacerbated by short selling.”¹² Reporting of short sale and short position information through prime brokers and clearing brokers, rather than through individual institutional investors, would provide the SEC with more usable, comprehensive short selling information and would better enable the SEC to identify and respond to any potential fraudulent short selling activity.

A. Type of Short Information Reported to the Commission

Reporting of client short sales and short positions by prime brokers and clearing brokers could provide the SEC with more complete, top-down information than reporting by individual institutional investors. Brokers gather and retain current, aggregate short sale information, including data on locate requirements, fails to deliver and “naked” short sales. Market participants also regularly provide order marking information to brokers pursuant to Rule 200(g) of Reg SHO. Prime and clearing brokers could include this information in reports they submit to the Commission, or they could provide the information to the Commission upon request if the Commission or its Staff has concerns regarding potential manipulative conduct taking place with respect to a particular security.

The additional information would provide the SEC with a broader perspective of shorting activity for a particular security than could be compiled solely from reporting of short sales and short positions by individual investors, and would be more useful in distinguishing manipulative “naked” short selling from unintentional failures to deliver. Short sales and short positions, as reported on Form SH, are less useful to determine whether short sales were conducted in a fraudulent manner. Under this proposed reporting system, the Commission could also receive and review short sale information of all investors that engage in short sales, including those not required to file a Form SH under current Rule 10a-3T.¹³

Prime brokers and clearing brokers could report all short sales and short positions, including those below the *de minimis* thresholds set out in Rule 10a-3T. Because prime brokers and clearing brokers generally have more sophisticated trading and data processing systems than investors, the burden imposed on brokers would be substantially less than that imposed on individual investors. In addition, these automated systems could allow more frequent reporting than weekly, if required by the Commission, and already provide data in a more efficient and user-friendly format than current reporting on Form SH. If the Commission does not amend the Rule to require reporting by prime brokers and clearing brokers, the SEC will continue to receive large

¹¹ Disclosure of Short Sales and Short Positions by Institutional Investment Managers, SEC Release No. 34-58785 (Oct. 15, 2008), 73 FR 61678 (Oct. 17, 2008).

¹² Release, page 4.

¹³ Under Rule 10a-3T(b)(1), only institutional investment managers that engage in reportable short sales and exercise investment discretion with respect to accounts holding section 13(f) securities that have filed, or are required to file, a Form 13F for the calendar quarter must file Form SH.

volumes of short sale and short position information from individual investors that it then must extensively analyze.

Under the alternative reporting regime that MFA proposes, the Commission would receive information from fewer reporting entities and use fewer resources to more efficiently identify and investigate manipulative conduct. The Staff could review consolidated information on a security-by-security basis from prime brokers and clearing brokers more easily than the current filings on an investor-by-investor basis. Once the Staff had identified a particular security or industry was identified as being a potential concern regarding fraudulent activity, the Staff would have precise data available to investigate, or could request additional short sale information from brokers for the security or industry. Such a reporting regime could have provided the Staff with more current, usable information than reporting by investors, for example, over the past several months as the prices of stocks of certain financial institutions experienced significant daily fluctuations.

B. Consistency with Existing Reporting Regimes

Reporting by prime brokers and clearing brokers would be consistent with current short interest reporting by broker-dealers. Pursuant to FINRA Rule 4560, member firms must report total short positions in all customer and proprietary firm accounts in securities listed on a national securities exchange and over-the-counter equity securities to FINRA on a semi-monthly basis.¹⁴ Member firms report short interest positions through FINRA's Regulation Filing Applications.¹⁵ FINRA then provides aggregate short interest data on a security-by-security basis to the respective exchanges on one uniform date at the end of each short interest reporting cycle for dissemination purposes. The procedures by which brokers aggregate short interest positions of their customer and proprietary accounts and submit short interest reports to exchanges could be adapted to short sale and short position reporting to the Commission.

A system of reporting by prime brokers and clearing brokers could also make use of information already reported by brokers. As noted above, investors are required to report order marking information to brokers under Rule 200(g) of Reg SHO. Moreover, member firms are required under the Order Audit Trail System Rules ("OATS") for Nasdaq-listed securities and the Order Tracking System ("OTS") for NYSE-listed securities, to record and report detailed information of order events to FINRA and the NYSE, respectively.¹⁶ OATS and OTS reporting already require broker member firms to capture much of the relevant data with respect to their orders and executions. In addition, broker-dealers currently must submit detailed securities transaction information upon request to the Commission for enforcement and other regulatory purposes through the Electronic Blue Sheet system.¹⁷ Reporting of short sale information by prime brokers and clearing brokers could make use of these existing requirements and facilities.

¹⁴ See SR-FINRA-2008-033, effective Dec. 15, 2008 and Order Approving Proposed Rule Change and Amendment No. 1 Thereto To Adopt FINRA Rule 4560 (Short-Interest Reporting) in the Consolidated FINRA Rulebook, SEC Release No. 34-58461 (Sept. 4, 2008), 73 FR 52710 (Sept. 10, 2008). Over-the-counter equity securities include any equity security that is not listed on a national securities exchange.

¹⁵ Available at <https://regfiling.finra.org>.

¹⁶ See FINRA Rule 7400 Series and NYSE Rules 132A-132C.

¹⁷ Exchange Act Rule 17a-25.

C. Risk of Public Disclosure

Prime brokers and clearing brokers could report short sale and short position information to the Commission in a manner that provides the Staff with tools to detect manipulation while reducing the risk of public disclosure of institutional investors' proprietary trading information. As noted in MFA's previous letters relating to the Emergency Orders, we support the Commission's determination that information on Form SH is and will remain confidential.¹⁸ If the Commission adopts reporting by prime brokers and clearing brokers, we also urge that the Commission not publicly disclose the information. We strongly believe that public disclosure of short sale information could have the perverse effect of increasing market volatility, being potentially misleading to the public, and causing irreparable harm to the proprietary trading strategies of money managers and harming fund investors, such as pensions, endowments and foundations.

Under current Rule 10a-3T(b)(4), information reported on Form SH will only remain non-public to the extent permitted by law. As a result, information submitted on Form SH could be subject to the Freedom of Information Act ("FOIA"), creating a substantial risk of public disclosure.¹⁹ Indeed, we understand that media organizations have already filed numerous blanket FOIA requests for short sale information reported on Form SH. In the Release, the Commission cites two exemptions from FOIA under which it has authority to withhold this information.²⁰ We strongly urge the SEC to affirm its intent to assert these exemptions against any claim filed under FOIA, including with respect to any claim to be determined by a court.²¹

If the SEC publicly discloses shorting information, the Commission probably would disadvantage those companies whose stock is shorted and the investors who are long in that stock. An institutional investor may put a short sale in place for risk management purposes, but the investing public might misinterpret disclosure of that information as a negative view on a company's prospects. Shorting of certain stocks may actually increase as other market participants follow firms' publicized short positions. A number of pension, endowment and foundation investors have indicated that because of headline risk, they would likely withdraw their investments from investment vehicles engaged in short selling if the SEC were to require public disclosure of short sales or short positions. The risk of public disclosure of Form SH could cause

¹⁸ See letter from Richard H. Baker, President and CEO, Managed Funds Association, to Christopher Cox, Chairman, Securities and Exchange Commission, dated Oct. 1, 2008, available in file No. S7-24-08. MFA believes that the Commission should not share this information with any other regulator or self-regulatory organization except under circumstances that protect the confidentiality of the information.

¹⁹ Cf. Section 24(d) of the Exchange Act, providing an exemption from FOIA for certain material obtained by the Commission from foreign securities authorities.

²⁰ Release, page 24. Exemption 4 is for trade secrets or privileged or confidential commercial or financial information obtained from a person. Exemption 8 is for matters 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.

²¹ Both exemptions are applicable to short sale information reported on Form SH. Form SH are reports prepared for the SEC, and the information consists of trade secrets, privileged and confidential information. Short sales are essential to the proprietary trading strategies of many investors, and provide numerous benefits to market efficiency, liquidity and price discovery.

investors with billions of dollars of assets to withdraw capital and further disrupt already stressed capital markets. In the long-term, pension, endowment and foundation investors would forego diversification and risk management benefits provided by alternative investment vehicles. In addition, some issuers have stated that if they determine which firms have been shorting their securities, that they will cease communications with analysts of those firms and exclude them from information sessions. Such a result would limit the free flow of information essential for informed investments and vibrant capital markets.²² We are concerned that the public disclosure of detailed short positions will have long lasting negative effects on our markets by having a chilling effect on the information and transparency provided by issuers, as well as subjecting investors to possible retaliation by issuers.

The risk of public disclosure of short sale and short position information could have unintended consequences on hedging strategies of institutional investors. Hedging strategies are a critical risk management tool of investors and enable investors to make investments on the long side of the market. Short selling is an essential component of a wide range of *bona fide* hedging strategies by which investors provide liquidity to the financial markets. For example, most investors in convertible bonds and convertible preferred securities seek to hedge their market risk by shorting the underlying stock to maintain a sufficient “delta” hedge. These convertible securities issuances enable companies to raise capital less expensively than they would in traditional debt markets, and serve as a stabilizing force in the market.²³ Under these convertible securities investment strategies, when stock prices rise, owners of convertible bonds and preferred securities sell short to hedge their exposure, and when stock prices decline, they buy to cover short positions and limit volatility to the down side. Similarly, the same dynamic occurs with respect to volatility strategies and option volatility positions, where participants attempt to cover short sales when prices fall and sell short when prices rise. Public disclosure of short positions could limit investors from engaging in short sale transactions for hedging purposes, and result in reduced market liquidity and capital allocation.

Public disclosure of information reported on Form SH could permit other market participants to unfairly reverse engineer the proprietary trading strategies of an investor. Even if only temporary, public disclosure would likely cause irreparable harm to the proprietary trading strategies of money managers, and by direct implication the billions of dollars invested in those strategies by investors such as pensions, endowments and foundations, as competitors will be able to use the publicly disclosed information not only to profit in the short term from the known positions, but also to reverse engineer the trading strategies themselves. In the Release, the Commission makes note of the potential harm to competition among investment managers if information on Form SH is publicly disclosed.²⁴

Significantly, we believe that the short sale information reported on Form SH if made public at any point in time will still engender the adverse consequences to markets, money managers and investors discussed above. Moreover, the mere potential for public disclosure by itself, as is the case under current Rule 10a-3T, could cause money managers to stop trading and providing liquidity to the market.

²² Such threats also raise questions under Regulation FD.

²³ See e.g., Short Sale Ban Wallops Convertible-Bond Market, Tom Lauricella, THE WALL STREET JOURNAL, Sept. 26, 2008.

²⁴ Release, page 42.

The concerns noted above could be substantially mitigated through reporting of short sale information by prime brokers and clearing brokers. Initially, short sales and short position information for each section 13(f) security could be provided by brokers to the Commission on an aggregate basis. The Commission could request specific information as to short sales and short positions of individual institutional investors if it suspected or became concerned about manipulation of a particular security. As described above, reporting by prime brokers and clearing brokers would provide the Commission with enhanced tools to identify manipulative activity on a security-by-security basis. The Commission would also have the ability at any time to request the short sale and short position information of any individual investor for any security. Such a reporting system would reduce the risk of public disclosure while providing the Commission with more comprehensive short selling information which would better enable it to identify and respond to any potential fraudulent short selling activity.

II. RECOMMENDED AMENDMENTS TO REPORTING REQUIREMENTS

If the Commission nevertheless decides to require reporting by individual investors, we believe the Commission should amend Rule 10a-3T to equip the Commission with tools to detect potentially manipulative short selling activity while minimizing the burden on individual filers. As a first principle, reporting of short sale information should reflect the Commission's long held view that short selling is essential for the healthy functioning of securities markets. The Commission recently affirmed that "short selling plays an important role in the market for a variety of reasons, including contributing to efficient price discovery, mitigating market bubbles, increasing market liquidity, promoting capital formation, facilitating hedging and other risk management activities, and importantly, limiting upward market manipulations."²⁵ We believe the recommendations discussed below will reduce the reporting burden on investors and enable the Commission to meet its objectives described in the Release.

A. Reporting of Short Sale Transactions and Short Sale Positions

The *de minimis* thresholds set by the Commission should be designed to enable it to identify potentially fraudulent short selling activity while limiting unnecessary burdens on investors. To this end, we recommend that the Commission consider requiring investors to report end of day short positions, rather than daily short sales. Short position-based information would be more helpful to the SEC in identifying potentially fraudulent short selling activity than transaction-based information. With position-based information, the Commission would receive more manageable, streamlined information and could more efficiently review short positions held in a specific security.

Position-based reporting would also significantly reduce the resources currently committed by the industry to tracking and reporting both short sale and short position information. Individual investors have devoted substantial resources to compliance with the Rule. Excluding the significant initial costs incurred to comply with the Disclosure Order, on a weekly basis, we estimate that investors dedicate between two and four days of personnel time to filing Form SH, in addition to legal fees for external counsel. Under a position-based reporting system, an investor would only

²⁵ Statement of Securities and Exchange Commission Concerning Short Selling and Issuer Stock Repurchases, SEC Release 2008-235 (Oct. 1, 2008).

need to monitor and report one type of short information and could devote resources to other appropriate business purposes.

We also note that Rule 10a-3T is unlikely to promote efficiency, competition, and capital formation.²⁶ As noted above, ongoing weekly compliance costs to investors are substantial and impose a significant burden on the industry. Position-based reporting would enhance efficiency for investors as well as the Commission. We also have strong concerns over the effects of the Rule on competition and capital formation. Information reported to the SEC on Form SH is only non-public to the extent permitted by law. If information were publicly disclosed under FOIA or otherwise, competition and capital formation would be substantially impaired for the reasons described in Section I.C above. For example, public disclosure of information reported on Form SH could harm competition if market participants are able to reverse engineer the proprietary trading strategies of another investor. In addition, capital formation could be impaired by public disclosure if investors reduced engaging in short sale transactions for hedging purposes, such as for convertible securities investment strategies.

B. Fair Market Value *De Minimis* Threshold

Current Rule 10a-3T requires an institutional investment manager to report short sales and short positions that equal or exceed either a percentage of the issuer's outstanding securities or a fair market value of \$10,000,000. An institutional investor, therefore, must perform two calculations for each short sale and short position to determine whether the information is reportable on Form SH. Elimination of the fair market value threshold would significantly simplify compliance with Rule 10a-3T and reduce the burden placed on investors to review transactions and ongoing short positions on a weekly basis. In addition, a single reporting threshold based only on short sales or short positions of a percentage of a class of the issuer's section 13(f) securities issued and outstanding would be consistent with the Commission's objectives and short selling reporting rules of most other foreign jurisdictions, including the U.K., which do not require an investor to calculate the fair market value of the securities in order to determine its reporting obligations.²⁷ Uniform short information reporting rules across jurisdictions would simplify reporting by investors currently subject to the disparate U.S. and non-U.S. requirements.

Use of a single percentage-based threshold would provide consistent treatment for reporting of short sales and short positions across all sizes of issuers. Under current Rule 10a-3T, an investor must report short sales and short positions that are less than 0.25% of that class of the issuer's section 13(f) securities issued and outstanding if the fair market value of the securities is at least \$10,000,000. Accordingly, the Rule requires disproportionately more reporting for short sales and short positions in issuers with high market capitalizations than for smaller issuers. Investors engaging in short sales of any issuer with greater than \$4 billion of section 13(f) securities issued and outstanding, for example, could be required to report information on Form SH that otherwise would be excluded if the issuer had a lower market capitalization. We believe this distinction is unnecessary, and that only a percentage threshold should be applied to determine a person's obligation to report.

²⁶ Under Section 3(f) of the Exchange Act, when the Commission is required to consider or determine whether an action is necessary or appropriate in the public interest, it must also consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.

²⁷ See e.g., Short Selling (No. 3) Instrument, FSA Release 51/2008 (Sept. 23, 2008).

C. Percentage *De Minimis* Threshold

In addition to the elimination of the fair market value threshold, we recommend that the *de minimis* reporting threshold of a percentage of a class of the issuer's section 13(f) securities issued and outstanding be increased from 0.25% to 2.0%. The requirement of reporting short sales and short positions that meet or exceed 0.25% of the issuer's securities does not strike an appropriate balance between providing information to the Commission that is both comprehensive and relevant. Short sales and short positions less than 2.0% of an issuer's securities issued and outstanding are unlikely to be meaningful in identifying fraudulent short sale activity. Particularly for large issuers, short sales and short positions below 2.0% are not significant to the market, and should be considered *de minimis*.

We also note that short information reporting rules adopted in certain other jurisdictions apply on a net basis. Rule 10a-3T, however, requires reporting of short sales and short positions on a gross basis, so that an investor with a hedged short position does not reduce the short position by the amount of its long position in reporting on Form SH. Reporting on a gross basis as compared to a net basis is more burdensome for an investor with a hedged position, and the Commission should increase the threshold from 0.25% to 2.0% to mitigate this additional reporting burden.

D. Scope of Short Information Reporting

Information reported to the Commission should include all cash short sales and exclude synthetic positions, such as over-the-counter derivatives, that do not create or expand a market short position. Synthetic instruments that do not create or expand a market short position would be misleading if reported. Reporting should be designed to capture short sales and market short positions of individual securities. For example, parties may enter into an over-the-counter equity derivative transaction, such as a bilateral swap, based on the value of an underlying equity security. Under the terms of the swap, a party would receive payment from a counterparty equivalent to any decrease in value of the underlying security. If the counterparty were to hedge its exposure to the swap by taking a short position in the underlying security, that hedging transaction should be reported as a short sale. The swap exposure, however, should not be reported as a short sale, as it would essentially double-count the short exposure in that underlying security. Furthermore, absent a hedge by the counterparty, the swap arrangement would not create or expand a market short position in the underlying security, and would be misleading if reported.

We also note the jurisdictional constraints on the Commission's ability to regulate certain derivative instruments, such as swap arrangements and futures contracts. The Commission itself cited those constraints in connection with its Emergency Order banning short sales of certain financial stocks, explaining that the Order differed from that imposed by the FSA because the SEC "does not have statutory authority over swap contracts and other non-security over-the-counter derivatives (other than prohibitions on fraud, manipulation, or insider trading regarding securities based swaps)."²⁸

²⁸ Statement of SEC Division of Trading and Markets Regarding Technical Amendments to Short Sale Order, SEC Release 2008-218 (Sept. 21, 2008).

E. Additional Comments

1. Reporting Elements

The Commission should not amend Rule 10a-3T to require reporting of elements included under the Emergency Orders (*i.e.*, the daily value of securities sold short, the largest intraday short position, and the time of day of the largest intraday short position). These elements were particularly difficult for investors to identify, and in some cases required manual tracking or could not be obtained. We support the Commission's decision to exclude these elements from reporting under the Rule and recommend that they be similarly excluded from any amendments to the Rule.

2. Frequency of Reporting

We recommend that the Commission also reconsider the frequency of reporting under the Rule, which currently requires weekly reporting of daily short sales and short positions. As noted above, weekly Form SH filings are burdensome for individual investors, especially smaller investors with less sophisticated information technology systems. Quarterly reporting of daily information, rather than weekly, along with position-based reporting, would alleviate reporting burdens and continue to provide the SEC with comprehensive short sale information.

3. Institutional Investment Managers

As noted, the Emergency Orders and Rule 10a-3T were issued in response to a period of market stress. Both the Disclosure Order and Rule 10a-3T apply only to an institutional investment manager that filed or was required to file a Form 13F (*i.e.*, managed long positions) as of the end of the most recent calendar quarter. We believe that investors should be subject to consistent regulatory requirements, and recommend that all investors engaging in short sales be subject to the Rule.

4. Aggregation of Short Positions

A disparity between the aggregation requirements of Form SH and the definition of short sale under Reg SHO may lead to reporting of short positions larger than those actually held by an investor. Rule 10a-3T(a)(2) incorporates the definition of short sale in Reg SHO Rule 200(a), which defines a short sale to include a sale of a long position if the investor is not net long in the security. As a result, the sale must be reported as a short sale on Form SH. The Rule defines a short position as the aggregate gross short sales of an issuer's section 13(f) securities (excluding options), less purchases to close out a short sale in the same issuer.²⁹ These provisions together require an investor that is net short a security to report long sales of the security as short sales and short positions on Form SH. Because an investor may only reduce its previously reported short positions by purchases to close out a short sale, after such a long sale the investor cannot reduce that particular reported short position.

The current Rule causes an inaccurate view of short sales by an investor that is net short the security. More notably, however, the Rule permanently distorts the amount of an investor's actual short positions following a long sale while net short. If an investor that has engaged in long sales while net short a security purchased enough securities to close out its entire short position, it

²⁹ Rule 10a-3T(a)(2).

would continue to report the short positions resulting from the reportable long sales. From the moment the long sales are reported as short sales and short positions, and indefinitely thereafter, the Rule requires reporting of short positions that do not exist.

Under a reporting system by prime brokers and clearing brokers, as described above, these concerns could be reduced if the brokers reported aggregate short sale information in part based on existing Reg SHO marking requirements. If the Commission continues to require reporting by individual investors, it should consider amending the definitions of short sale and short position to more accurately reflect the shorting activity of an investor.

5. Debt Securities

The Commission should amend Rule 10a-3T to exclude reporting of debt instruments that are section 13(f) securities. Debt securities generally are not the subject of potentially fraudulent short selling activity, and accordingly are outside the scope of Reg SHO, which applies only to equity securities and securities convertible into equity securities. The exclusion of debt securities from Reg SHO clearly illustrates that concerns of manipulative short selling activity are not applicable to debt securities.

6. Section 13(f) List

If the Commission continues to require reporting by investors, it should update the official section 13(f) list at least as often as investors report short information. Currently each investor must track on a weekly basis any changes to the securities on the list (*e.g.*, a new CUSIP number due to an issuer's name change) after its publication. Tracking changes to the list is burdensome and operationally challenging for individual investors.

F. Expiration of Reporting Requirements

The Release sets out that Rule 10a-3T and Form SH will be effective from October 18, 2008 until August 1, 2009. We request that the SEC not extend the Rule, and following its expiration undertake a detailed study of the effects of Rule 10a-3T and any proposed reporting requirements. The study should at a minimum analyze the extent of any manipulative conduct with regard to short selling that occurred prior to and subsequent to the effective date of the Rule (and Emergency Orders), the value of the reported information in identifying and punishing such manipulative activity, and the reporting burden imposed on investors. We believe that Regulation SHO is an effective regulatory structure governing short selling, and that any modifications, including any short selling disclosure requirement, should be preceded by a comprehensive review by the SEC Staff similar to that which accompanied its implementation.³⁰

³⁰ See *e.g.*, Order Suspending the Operation of Short Sale Price Provisions for Designated Securities and Time Periods, SEC Release No. 34-50104 (July 28, 2004), 69 FR 48032 (Aug. 6, 2004). We note also that the FSA is currently conducting a review of its short selling rules and intends to release a Consultation Paper on short selling in January 2009. See also FSA Statement on Short Positions in Financial Stocks, FSA Release 102/2008 (Sept. 18, 2008).

III. CONCLUSION

MFA supports the Commission in its efforts to prevent, detect and punish manipulative conduct with regard to short selling. We believe a system of reporting by prime brokers and clearing brokers would most effectively provide the Commission with the appropriate information to accomplish this objective, and help to ensure the Commission's intent that short information reported to the SEC not be disclosed to the public. In the alternative, we recommend Rule 10a-3T be amended to reduce undue and unnecessary burdens on individual investors required to report short information on Form SH. We welcome an opportunity to further discuss any of the recommendations made above with Commissioners or Staff if it would assist in your rulemaking efforts. If the Staff has any questions or comments, please contact Matthew Newell or the undersigned at (202) 367-1140.

Respectfully submitted,



Stuart J. Kaswell
Executive Vice President and General Counsel

CC: The Hon. Christopher Cox, Chairman
The Hon. Kathleen L. Casey, Commissioner
The Hon. Elisse B. Walter, Commissioner
The Hon. Luis A. Aguilar, Commissioner
The Hon. Troy A. Paredes, Commissioner
Dr. Erik Sirri, Director
 Division of Trading and Markets
Robert Colby, Deputy Director
 Division of Trading and Markets
James Brigagliano, Associate Director
 Division of Trading and Markets