SIFMA
Securities Industry and
Financial Markets Association

May 22, 2008

Ms. Nancy M. Morris
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-9303

Re: Release No. 34-57511; File Number S7-08-08
Proposed Rule 10b-21

Dear Ms. Morris:

The Securities Industry and Financial Markets Association ("SIFMA")[1] appreciates the opportunity to comment on the Securities and Exchange Commission's (the "SEC" or "Commission") proposed anti-fraud rule, Rule 10b-21 (the "Rule"),[2] which is intended to target: (i) short sellers who deceive certain persons, such as their broker-dealers, about the source of borrowable shares, in order to circumvent the Regulation SHO "locate" requirement; and (ii) long sellers who misrepresent to their broker-dealers that they own the shares being sold. Specifically, Proposed Rule 10b-21 would be violated if: (1) a seller of a security deceives a broker-dealer, participant of a registered clearing agency, or purchaser regarding its intention or ability to deliver the security sold on the date delivery is due; (2) the seller fails to deliver the security sold; and (3) the seller acts with scienter.

I. Introduction and Executive Summary

SIFMA strongly supports the SEC's stated goals of addressing potentially abusive "naked short selling" practices. Though not defined, naked short selling generally refers to instances where a short seller fails to confirm that there are reasonable grounds to believe the security sold can be delivered on settlement date, which may lead to the seller's broker-dealer not being able to deliver securities within the normal three business

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[1] The Securities Industry and Financial Markets Association brings together the shared interests of more than 650 securities firms, banks and asset managers. SIFMA's mission is to promote policies and practices that work to expand and perfect markets, foster the development of new products and services and create efficiencies for member firms, while preserving and enhancing the public's trust and confidence in the markets and the industry. SIFMA works to represent its members' interests locally and globally. It has offices in New York, Washington D.C., and London and its associated firm, the Asia Securities Industry and Financial Markets Association, is based in Hong Kong.

[2] Securities Exchange Act Release No. 57511 (March 17, 2008), 72 FR 15376 (March 21, 2008) ("Proposing Release").

day settlement cycle (typically referred to as a "fail-to-deliver" or "fail"). While the Commission has recognized that naked short selling and/or failing-to-deliver shares is not necessarily manipulative or violative under all circumstances,[3] it has also noted that naked short selling can cause market operational problems, and may be used as a tool for manipulation. SIFMA firms strongly support attempts to address and prevent manipulative trading activity. SIFMA also applauds and supports the Commission's stated attempts to "aid broker-dealers in complying with the locate requirement of Regulation SHO"[4] and properly focus responsibility for potentially abusive activity on the party who is providing false information to the broker-dealer.

The SEC has used its broad market authority to adopt rules and regulations governing naked short selling, chief among which is Regulation SHO ("Reg SHO"). As repeatedly noted by the Commission, overall Reg SHO appears to be having its intended effects without imposing undue impacts on the market, as evidenced by a steadily-declining level of fails-to-deliver, as well as a declining number of Threshold Securities.[5] Of equal importance, and due in large measure to the market disciplines imposed by Reg SHO, the overall number of fails-to-deliver is also extremely low, with data from the National Securities Clearing Corporation ("NSCC") showing that 99% (by dollar value) of all trades settle on time.[6] This being the case, the SEC has continued to actively monitor and interpret Reg SHO, including taking recent action to address what it perceives to be persistent fails-to-deliver in a small handful of Threshold Securities, namely by eliminating the Reg SHO "Grandfather" provision.

While SIFMA firmly supports the Commission's attempts to address and prevent manipulative activity, SIFMA does not believe that enactment of a new anti-fraud rule that might have unintended consequences is the most efficient means available to the Commission to achieve its goals. Rather, SIFMA believes that the better approach to address concerns about sellers engaging, or attempting to engage, in naked short selling through misrepresenting information is for the Commission to act upon the proposed amendments to the 1994 Prime Broker No-Action Letter ("Prime Broker Letter"). These amendments have been the subject of numerous discussions with the Staffs of both the

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[3] "Naked short selling is not necessarily a violation of the federal securities laws or the Commission's rules. Indeed, in certain circumstances, naked short selling contributes to market liquidity. For example, broker-dealers that make a market in a security generally stand ready to buy and sell the security on a regular and continuous basis at a publicly quoted price, even when there are no other buyers or sellers. Thus, market makers must sell a security to a buyer even when there are temporary shortages of that security available in the market. This may occur, for example, if there is a sudden surge in buying interest in that security, or if few investors are selling the security at that time. Because it may take a market maker considerable time to purchase or arrange to borrow the security, a market maker engaged in bona fide market making, particularly in a fast-moving market, may need to sell the security short without having arranged to borrow shares." SEC, *Division of Market Regulation: Key Points About Regulation SHO* (April 11, 2005).

[4] Proposing Release, 72 FR at 15380.

[5] *See* Memorandum from the Commission's Office of Economic Analysis, dated August 21, 2006.

[6] Proposing Release, 72 FR at 15377.

SEC and FINRA, and have been pending with the SEC for some time. Additionally, SIFMA believes that Section 10(b) of the Exchange Act and Rule 10b-5 thereunder already provide the Commission with ample authority to address manipulative or fraudulent trading activity. The Commission has, in fact, already utilized such authority to address naked short selling abuses.[7]

To the extent the Commission still believes that a specific anti-fraud rule addressing naked short selling is necessary, SIFMA urges the Commission to provide clarification and address certain inconsistencies in the current language of proposed Rule 10b-21, as identified herein. SIFMA's comments, recommendations and responses to questions are provided in greater detail below.

II. Primary Recommendations to Address Naked Short Selling Concerns

a. Amend the Prime Broker Letter

Proposed Rule 10b-21 seeks to target situations where a customer misrepresents to its executing broker that it has obtained an away locate, or is a "long" seller. As the Commission is aware, in the prime brokerage context it is generally industry practice for an executing broker to reasonably rely on a customer's representation that a locate on a "short" sale has been obtained with the customer's prime broker (*i.e.*, an "away locate"). This arrangement is not only expressly permitted under Reg SHO,[8] it is perfectly logical, since the prime broker generally bears responsibility for settlement of the customer's short sale. It is also industry practice in the prime brokerage context for an executing broker to reasonably rely on a customer's representation of a "long" sale, in that the customer's positions are held away at the prime broker.

SIFMA strongly encourages the SEC to continue to allow executing brokers to be able to reasonably rely on such customer representations, as prohibiting such reasonable reliance would adversely affect and needlessly delay the executions of clients' legitimate orders.[9] Furthermore, a prohibition on away locates would be severely detrimental to

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[7] *See, e.g., Sandell Asset Management Corp. et. al.*, Securities Exchange Act Release No. 8857 (October 10, 2007).

[8] The SEC had stated as follows in the Reg SHO Adopting Release: "A broker-dealer may obtain an assurance from a customer that such party can obtain securities from another identified source in time to settle the trade. This may provide the 'reasonable grounds' required by Rule 203(b)(1)(ii). However, where a broker-dealer knows or has reason to know that a customer's prior assurances resulted in failures to deliver, assurances from such customer would not provide the 'reasonable grounds' required by 203(b)(1)(ii). The documentation required by Rule 203(b)(1)(iii) should include the source of securities cited by the customer. The broker-dealer also should be able to demonstrate that there are 'reasonable grounds' to rely on the customer's assurances, *e.g.*, through documentation showing that previous borrowings arranged by the customer resulted in timely deliveries in settlement of the customer's transactions." Securities Exchange Act Release No. 50103 (July 28, 2004), 69 FR 48008, 48014 (August 6, 2004).

[9] The SEC specifically asked about such reliance, stating as follows in the Proposing Release: "In the 2004 Regulation SHO Adopting Release, the Commission stated that a broker-dealer could satisfy the locate requirement of Regulation SHO by obtaining an assurance from a customer that the customer can

small executing brokers that may not have comparable access to a large stock loan supply.

This being the case, SIFMA believes that the Commission already has in its possession sufficient means to address potential customer misrepresentations to executing brokers in the form of the revised Prime Broker Letter. As the Commission is aware, the industry, through the SIFMA Prime Brokerage Committee, has engaged in extensive collaborative efforts with the Staffs of both the SEC's Division of Trading and Markets and FINRA regarding revisions to the Prime Broker Letter. These revisions are intended to enhance communications between the prime broker and executing broker and to help ensure that the customer is providing accurate information to the executing broker.[10]

While implementing the requirements of the new Prime Broker Letter will necessitate both executing brokers and prime brokers engaging in extensive systems modifications, SIFMA firms generally support the clarity and guidance that it will provide on the application of Reg SHO in the prime brokerage context. Specifically, the revised Prime Broker Letter will create a mechanism for prime brokers and executing brokers to seamlessly communicate such information concerning customer "long" sales and "short" sales, through the Omgeo system. This mechanism is otherwise not presently available.

b. Utilize Existing Authority Under 10(b) and Rule 10b-5

While clearly well-intentioned, SIFMA believes proposed Rule 10b-21 is unnecessary because the Commission already has ample existing authority, under Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, to prosecute manipulative and/or fraudulent activity, including the type of activity that proposed Rule 10b-21 seeks to address. Moreover, creating a new anti-fraud rule specifically targeted at naked short selling may create uncertainty and confusion. For example, market participants would

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obtain securities from another identified source in time to settle the trade, provided the broker-dealer reasonably believes the customer's assurance. Proposed Rule 10b-21 is aimed, in part, at sellers who make misrepresentations to their broker-dealers about their locate sources. Should we instead no longer permit a broker-dealer to rely on such customer assurances in satisfying the locate requirement of Regulation SHO? What would be the costs and benefits of removing the ability of broker-dealers to rely on such customer assurances? What would be the impact on market participants (such as broker-dealers, stock lenders, investors)? Would smaller entities be affected more or less adversely than larger entities?"

[10] With respect to "long" sales, the proposed new Prime Broker Letter generally places an obligation on the prime broker to determine whether a customer owned securities that were executed "long" at an executing broker, and advise the executing broker, through the Omgeo system, on situations where the customer did not in fact own the securities sold. With respect to "short" sales, the new Prime Broker Letter generally places an obligation on the prime broker to review information received from the executing broker regarding a customer short sale. If the prime broker does not have a record of providing a locate to the customer, and cannot borrow the security, then the prime broker must contact the customer to determine the source of the locate, and also contact such source to confirm that a locate was provided to the customer and attempt to borrow such security. In the event that the source identified by the customer does not have a record of providing a locate to such customer, or does have such a record but does not deliver the shares on settlement date, then the prime broker is required to advise the executing broker of this fact, again through the Omgeo system.

not only need to consider the parameters and interpretations of new Rule 10b-21, but new questions might also be raised whether other types of activity might be actionable under the general provisions of 10(b), given that the Commission has not decided to address such activity in a separate 10(b) rule.

SIFMA is also concerned that the creation of the proposed new anti-fraud rule might create uncertainty as to whether courts would similarly interpret in the Rule 10b-21 context the precedent that has been established with respect to Section 10(b) and Rule 10b-5 thereunder. For example, although the Proposing Release does not specifically address private rights of action for violation of proposed Rule 10b-21, a question on this point was raised at the Commission's Open Meeting on the Rule. SIFMA notes, in this regard, that Congress has not provided any express cause of action for private citizens to sue for civil damages for violation of proposed Rule 10b-21, nor for violations of any of the provisions of the Exchange Act cited by the Commission as authority for the Rule.[11] Accordingly, any authority for a private right of action must be found in the judicially implied right of action under Section 10(b) but, as the Supreme Court has emphasized, that right of action cannot be expanded without authorization from Congress.[12]

As the Court has repeatedly emphasized, "Rule 10b-5 encompasses only conduct already prohibited by Section 10(b)."[13] The Court has expressly held that the Commission lacks authority to expand the scope of the private right of action when it held that scienter is required for all Section 10(b) private actions even though the language of subparts (b)&(c) of Rule 10b-5 "could be read as" imposing liability "whether the wrongdoing was intentional or not."[14] "The rulemaking power granted to an administrative agency charged with the administration of a federal statute is not the power to make law . . . [t]hus, despite the broad view of the Rule advanced by the Commission in this case, its scope can not exceed the power granted the Commission by Congress under Section 10(b)."[15]

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[11] Specifically, Exchange Act §§ 2, 3(b), 6, 9(h), 10, 11A, 15, 15A, 17, 17A, 19 & 23(a), 15 U.S.C. §§ 78b, 78c(b), 78f, 78i(h), 78j, 78k-1, 78o, 78o-3, 78q, 78q-1, 78s & 78w(a).

[12] "Concerns with the judicial creation of a private cause of action caution against its expansion. The decision to extend the cause of action is for Congress, not for us. Though it remains the law, the § 10(b) private right should not be extended beyond its present boundaries. . . . It is appropriate for us to assume that [when it enacted the Private Securities Litigation Reform Act of 1995], Congress accepted the § 10(b) private cause of action as then defined but chose to extend it no further." *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 128 S. Ct. 761, 773 (2008).

[13] *Id.* at 768. *See also United States v. O'Hagan*, 521 U.S. 642, 651 (1997) ("Liability under Rule 10b-5 . . . does not extend beyond conduct encompassed by § 10(b)'s prohibitions."); *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 175, 177 (1994) ("[T]he statutory text controls the definition of conduct covered by § 10(b) . . . [it is] inconsistent with settled methodology in § 10(b) cases to extend liability beyond the scope of conduct prohibited by the statutory text."); *Santa Fe Indus., Inc. v. Green*, 430 U.S. 462, 473-74, 475 n. 14 (1977) (a "complaint states a cause of action under any part of Rule 10b-5 only if the conduct can be fairly viewed as 'manipulative or deceptive' within the meaning of the statute.").

[14] *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 212-214 (1976).

[15] *Id.* at 213-14. The Court reaffirmed this conclusion in *Aaron v. SEC*, 446 U.S. 680, 690, 695-97

Following this guidance, the courts have repeatedly held that, because any implied right of action under Rules 10b-10 and 10b-16 would have to arise from Section 10(b), it must satisfy all of the elements of the Section 10(b) implied right of action.[16] Because proposed Rule 10b-21 similarly depends upon the implied Section 10(b) cause of action as authority for the imposition of private civil liability in the absence of express authorization by Congress, it should similarly be expressly subject to all of the requirements of a Section 10(b) claim and the PSLRA, including pleading and proof of reliance, scienter, materiality, loss causation, damages, standing and a manipulative or deceptive device employed in connection with the purchase or sale of securities.

III. Secondary Recommendation – Adopt Modified Version of Anti-Fraud Rule

To the extent the Commission still believes that an anti-fraud rule addressing naked short selling is necessary, SIFMA encourages the SEC to resolve to address certain inconsistencies in the current form of proposed Rule 10b-21, as well as clarify related issues, as identified below.

a. Amend Rule's Current Focus on "Seller's Fail"

Proposed Rule 10b-21, as drafted, would be violated if the following occurred: (1) a seller of a security deceives a broker-dealer, participant of a registered clearing agency, or purchaser regarding its intention or ability to deliver the security sold on the date delivery is due; (2) *the seller fails to deliver the security sold*; and (3) the seller acts with scienter. As the Staff is aware, the seller's clearing firm, rather than the seller, will generally bear the obligation to meet its CNS delivery requirement, and thus SIFMA recommends that the Rule instead focus on whether there is a CNS fail, while also maintaining the requirement that the broker-dealer be deceived, and the seller act with scienter. In this regard, SIFMA notes the Commission's prior recognition that, because NSCC's continuous net settlement system ("CNS") nets all buys and sells in each security, broker-dealers cannot readily determine which customer's transaction or

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(1980), which held that scienter is not required under §§ 17(a)(2) & (3) of the 1933 Act – while those statutes use the same language as Rule 10b-5(b)&(c), the Court reached a different outcome than in *Hochfelder* because the language was contained in the statutes themselves.

[16] *See, e.g., Arst v. Stifel, Nicolaus & Co.*, 86 F.3d 973, 977 (10th Cir. 1996) (claim under Rule 10b-10 dismissed for failure to meet statutory "in connection with" requirement); *Angelastro v. Prudential-Bache Secs., Inc.*, 764 F.2d 939, 946 (3d Cir. 1985) (Rule 10b-16 claim must meet statutory "in connection with" requirement); *Robertson v. Dean Witter Reynolds, Inc.*, 749 F.2d 530, 540 (9th Cir. 1984) (claim under Rule 10b-16 must satisfy statutory scienter requirement). *See also Morris v. Wachovia Secs., Inc.*, 277 F. Supp. 2d 622, 638 n. 9 (E.D. Va. 2003) (dismissing Rule 10b-10 claim for failure to allege statutory elements of reliance and loss causation); *Bissell v. Merrill Lynch & Co.*, 937 F. Supp. 237, 245 (S.D.N.Y. 1996) (dismissing Rule 10b-16 claim for failure to allege statutory "in connection with" requirement and statute of limitations), *aff'd on other grounds*, 157 F.3d 138 (2d Cir. 1998); *Levitin v. PaineWebber, Inc.*, 933 F. Supp. 325, 330-31 (S.D.N.Y. 1996) (dismissing Rule 10b-10 and 10b-16 claims for failure to allege statutory "in connection with" requirement), *aff'd on other grounds*, 159 F.3d 698, 707 (2d Cir. 1998). *Cf. Greenblatt v. Drexel Burnham Lambert, Inc.*, 763 F.2d 1352, 1358 n. 8 (11th Cir. 1985) (noting that any cause of action under Rule 10b-16 would need to meet statutory elements).

account gave rise to a fail-to-deliver.[17] As such, SIFMA urges that Rule 10b-21's focus remain on the "seller," and that a broker-dealer not be held to unreasonable standards with respect to monitoring its CNS fail-to-deliver position for purposes of determining potential violations of Rule 10b-21 by sellers.

SIFMA also notes that the Commission raised a question in the Proposing Release as to whether the inclusion of a fail as a necessary element of the proposed Rule would encourage broker-dealers to deliver securities to prevent customers from failing.[18] As a general matter, a participant broker-dealer will attempt to deliver securities to satisfy its CNS delivery obligation, which may reflect both long sale and short sale activity. Given the fungible nature of securities in CNS, any transfer of securities from a participant broker-dealer's DTC account to NSCC's account at DTC to cover a CNS delivery obligation may, and for most larger broker-dealers will, include borrowed securities. As the Commission is aware SIFMA has pending a long-standing no-action request which would clarify that a broker-dealer borrowing securities in this manner to satisfy its bulk settlement obligations does not constitute a violation of Rule 203(a) of Reg SHO. SIFMA would strongly encourage the Commission to take the opportunity here to confirm the guidance that would be provided by this request.

b. Limit to Threshold Securities

In response to the SEC's question, SIFMA believes that Rule 10b-21 should be narrowly-tailored to only cover Threshold Securities. In focusing on Threshold Securities, for purposes of the Reg SHO close-out requirement, the SEC had specifically indicated in the 2004 Reg SHO Adopting Release that "This narrowly targeted threshold will not burden the vast majority of securities where there are not similar concerns regarding settlement," noting further that "imposing a lower threshold or, as suggested by some commenters, prohibiting all fails, might be an impracticable or an overly-broad method of addressing any potential abuses, and could also disrupt the efficient functioning of the Continuous Net Settlement System…"[19] SIFMA believes these same rationales warrant limiting Rule 10b-21 to only Threshold Securities. As was indicated in the Release, fails-to-deliver generally occur in less than 1% of all transactions,[20] and therefore applying Rule 10b-21 to all securities would neither be necessary or prudent.

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[17] The Commission had stated as follows in the 2004 Reg SHO Adopting Release: "Some commenters argued that under the confines of current settlement practices and procedures, it is not practical to assign delivery failures to a particular clearing firm customer account. It was noted that because NSCC's continuous net settlement ('CNS') system nets all buys and sells in each security for each NSCC participant, broker-dealers cannot determine which customer's transaction or account gave rise to a failure to deliver." Securities Exchange Act Release No. 50103 (July 28, 2004), 69 FR 48008 (August 6, 2004).

[18] "Would the inclusion of a fail to deliver as an element of the proposed rule encourage broker-dealers, as a service to customers, to deliver securities on behalf of customers to prevent customers from failing to deliver securities by settlement date? Would broker-dealers feel any additional obligation to purchase or borrow securities on behalf of their customers to deliver on a customer's sale?"

[19] 69 FR at 48016.

[20] Proposing Release, 72 FR at 15377.

c. Scienter Requirement

SIFMA understands that, although the manipulative short selling activity that Rule 10b-21 is intended to address may already be actionable under 10(b) and Rule 10b-5, the Commission believes that a rule "highlighting the illegality of these activities would focus the attention of market participants on such activities." This being the case, SIFMA requests the Commission's confirmation that the concept of scienter, for purposes of Rule 10b-21, be identical to established precedent under 10(b) and Rule 10b-5 thereunder.

d. Clarify Broker-Dealer' Aiding and Abetting Liability

By targeting situations where a customer misrepresents to its executing broker that it has obtained an away locate, or is a "long" seller, proposed Rule 10b-21 may assist an executing broker in meeting its requirement to have "reasonable grounds" to believe the customer is providing accurate information. This being the case, the SEC indicated in the Proposing Release that an executing broker in such situation might still be primarily liable, under Regulation SHO, or secondarily liable for aiding and abetting a violation of Rule 10b-21.[21]

SIFMA is troubled by the Commission's statements in the Proposing Release, and believes that they introduce uncertainty for broker-dealers with respect to their compliance obligations under proposed Rule 10b-21. Proposed Rule 10b-21 specifically applies to sellers, who are best postured to know their own obligations and ensure compliance therewith. While SIFMA recognizes that broker-dealers cannot turn a blind eye to illegal activities by their customers, broker-dealers should not be held responsible for policing their customers' compliance with their own legal requirements. Furthermore, because proposed Rule 10b-21 contains as a key element the fact that the seller deceive the broker-dealer, it is unclear in what situations a broker-dealer would know of, and aid and abet a violation.

SIFMA would therefore urge the Commission to reconsider its statements concerning broker-dealer's liability for aiding and abetting. As noted above, SIFMA believes that the best approach to address concerns about sellers engaging, or attempting to engage, in naked short selling through misrepresenting information is for the Commission to act upon the proposed amendments to the 1994 Prime Broker No-Action Letter.

e. "Long" Sales by Firm Aggregation Units

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[21] "Although the proposed rule is primarily aimed at sellers that deceive specified persons about their intention or ability to deliver shares or about their locate source and ownership of shares, as with any rule, broker-dealers could be liable for aiding and abetting a customer's fraud under the proposed rule. In addition, broker-dealers would remain subject to liability under Regulation SHO and the general anti-fraud provisions of the federal securities laws." *Id.*

Although the Proposing Release indicates that broker-dealers acting for their own accounts would be considered "sellers," for purposes of Rule 10b-21, SIFMA would request the Commission's clarification that a violation of Rule 10b-21 would not occur where an aggregation unit within a broker-dealer marks a sale "long," based on its net position, however, due to other CNS activity, the broker-dealer may have a CNS fail-to-deliver position. Rather, in order for a potential violation of Rule 10b-21 to occur, the aggregation unit would need to be engaging in deception, and also acting with scienter.

f. Clarify Coverage of "Purchasers" Under Rule 10b-21

The current language of proposed Rule 10b-21 indicates that it shall be a violation for a seller to deceive "a purchaser" about its intention or ability to deliver the security on the settlement date. SIFMA notes that, in the event that a person purchases securities, but their broker-dealer may have a CNS fail-to-receive, such person is still deemed to be an owner of such securities, and is entitled to exercise all rights of ownership, including selling the position. Therefore, despite the fact that some commenters may allege that fails-to-deliver result in the purchaser of the securities paying for shares, but never receiving them (*i.e.*, there are allegations made that these are "phantom shares"), the Commission has previously noted that this assertion is simply not accurate.[22]

SIFMA is concerned that the extension of proposed Rule 10b-21 to "purchasers" may subject broker-dealers to meritless civil litigations that would impose tremendous costs to defend. The end result could be a chilling effect on legitimate short selling, which as the Commission has noted, provides numerous benefits to the market, including: (i) countering unwarranted, speculative upward price pressure in stocks, and even uncovering and exposing fraudulent issuer activities; (ii) enabling a person to hedge the risk of a stock position owned, and thereby protect against a price decline; (iii) providing liquidity in response to buyer demand; (iv) providing latent buying interest; and (v) facilitating efficient markets.

SIFMA would therefore request that the Commission either remove the concept of deceiving a "purchaser" from Rule 10b-21, or clarify that 10b-21 would only apply in the event that a purchaser was deceived in the course of direct communications with a seller, and where such transaction settles outside of the Continuous Net Settlement System ("CNS").

g. Pending Long Sale Documentation Requirements Under Regulation SHO

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[22] Specifically, the Commission noted in a prior Amicus brief that: "The fact that a broker-dealer that is an NSCC member fails to receive securities that it purchased on behalf of a retail customer does not mean that the customer's purchase is not completed until the member's failure to receive is cured. Under Article 8 of the Uniform Commercial Code, a securities broker may credit a customer's account with a security even though that security has not yet been delivered to the broker-dealer's account by NSCC. In that event, the customer receives what is defined under the Uniform Commercial Code as a securities entitlement,' which requires the broker-dealer to treat the person for whom the account is maintained as entitled to exercise the rights that comprise the security." *See Nanopierce Technologies, Inc. vs. The Depository Trust and Clearing Corporation* , Supreme Court of Nevada, Case No. 45364, Brief of the Securities and Exchange Commission (February 2006).

The Commission currently has pending proposed amendments to Regulation SHO, which would require broker-dealers, with respect to all sales marked long, to document the present location of the securities being sold.[23] As the Commission is aware, SIFMA had strongly opposed such proposal, in that it would involve significant and costly systems programming changes, and could actually result in unintended negative consequences, including harming customers by hindering execution quality and market liquidity. SIFMA is therefore hopeful that the Commission has decided to not proceed further with the proposed long sale documentation requirements, choosing instead to pursue proposed Rule 10b-21 and the proposed amended Prime Broker Letter, as alternatives.

h. "Long" Sales of Rehypothecated Securities

SIFMA notes that the Commission definitively stated in the Proposing Release that:

> "a seller would not be making a representation at the time it submits an order to sell a security that it can or intends to deliver securities on the date delivery is due if the seller submits an order to sell securities that are held in a margin account but the broker-dealer has loaned out the shares pursuant to the margin agreement. Under such circumstances, it would be reasonable for the seller to expect that the securities will be in the broker-dealer's physical possession or control by settlement date."[24]

This positive statement by the SEC appears to resolve uncertainties that have existed since the inception of Regulation SHO concerning whether, under a strict reading of the rule, it is permissible for a broker-dealer to mark as "long" a sale by a customer of securities which have been rehypothecated, even where delivery by the broker-dealer technically may be consummated with borrowed shares. In such case, these transactions do not, in fact, meet the definition of "short sale" in Rule 200(a) because the delivered securities are neither borrowed by the customer, nor borrowed for the account of the customer.[25] Instead, they are borrowed by the broker-dealer, for its own account, and appear as a "borrow" obligation of the broker-dealer on the firm's books and records (*i.e.*, the broker-dealer, and not the customer, has the obligation to return the securities and bears the market risk). To be sure, a broker-dealer's rehypothecation of customers' margin securities in this manner does not at all affect the customer's long position with respect to those securities – *i.e.*, the customer is still "deemed to own" the securities

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[23] Securities Exchange Act Release No. 56213 (August 7, 2007), 72 FR 45558 (August 14, 2007).

[24] Securities Exchange Act Release No. 57511 (March 17, 2008), 72 FR 15376, 15379 (March 21, 2008).

[25] As you know, Rule 200(a) defines a "short sale" as "any sale of a security which the seller does not own or any sale which is consummated by the delivery of a security borrowed by, or for the account of, the seller." 17 C.F.R. § 242.200(a).

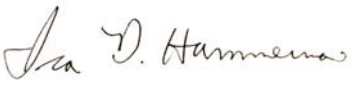
within the meaning of Rule 200(b), and his or her account statements continue to show any rehypothecated margin securities as long positions. So as to avoid any doubt, SIFMA requests that the Commission confirm this view in the Adopting Release.

IV. Conclusion

In summary, SIFMA strongly supports the Commission's efforts to address potentially abusive naked short selling, and likewise appreciates that the proposed Rule properly shifts responsibility for such potentially abusive activity away from broker-dealers, and towards a party who is providing false information to the broker-dealer. As noted above, rather than adopting a new anti-fraud rule, SIFMA believes that these policy goals can be best accomplished by implementing the pending amendments to the Prime Broker Letter, and through the Commission's existing authority to address manipulative trading activity under Section 10(b), and Rule 10b-5 thereunder. Should the Commission decide to proceed with 10b-21 however, SIFMA would respectfully request that the Commission consider the important points noted above, and adopt an amended version of the Rule.

If you have any questions or require additional information, please do not hesitate to contact the undersigned at 202-434-8400 or Amal Aly, SIFMA Vice President and Associate General Counsel, at (212) 313-1268. Thank you for your attention to this request.

Sincerely,



Ira D. Hammerman
SIFMA Managing Director and
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