



February 19, 2004

Via e-mail: rule-comments@SEC.gov

Mr. Jonathan G. Katz
Secretary
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, DC 20549

Re: Short Sales – Proposed Regulation SHO: File No. S7-23-03

Dear Mr. Katz:

This letter is being submitted by the Derivative Products Committee (the “Committee”) of the Securities Industry Association (the “SIA”)¹ to comment on proposed Regulation SHO. Proposed Regulation SHO would replace, expand and/or supplement current SEC and self-regulatory organization rules regarding short sales. One of the main features of the proposal is Rule 201, which would replace current short sale price regulations with a uniform bid test. It also would include a pilot program under which certain highly liquid stocks would be exempted from the Regulation’s pricing restrictions in order to permit examination of the need for such restrictions in the current markets.²

¹ The Securities Industry Association, established in 1972 through the merger of the Association of Stock Exchange Firms and the Investment Banker’s Association, brings together the shared interests of nearly 600 securities firms to accomplish common goals. SIA member-firms (including investment banks, broker-dealers, and mutual fund companies) are active in all U.S. and foreign markets and in all phases of corporate and public finance. According to the Bureau of Labor Statistics, the U.S. securities industry employs more than 800,000 individuals. Industry personnel manage the accounts of nearly 93 million investors directly and indirectly through corporate, thrift, and pension plans. In 2002, the industry generated \$222 billion in domestic revenue and \$304 billion in global revenues. (More information about SIA is available on its home page: www.sia.com.) SIA’s Derivative Products Committee monitors and comments on legislative and regulatory proposals that impact corporate finance activities involving swaps and related products across the equity, interest rate, commodity, and currency markets.

² Proposed Rule 202 would suspend operation of the proposed uniform bid test for specified liquid securities for a two year pilot period. See Securities Exchange Act Release No. 48709 (October 28, 2003), 68 Fed. Reg. 62971 (November 6, 2003) (the “Proposing Release”), at 62983.

A hedging exemption for short sales was not included in Rule 201 because the Commission believes that the proposed bid test and the proposed pilot program will provide sufficient additional flexibility to effect short sales to hedge long exposure. In the Proposing Release, the Commission requested comments regarding whether a hedging exemption should be added to proposed Rule 201 and, if so, how the exemption could be designed so that it can be monitored and not subject to abuse. The Commission also noted that security futures are not subject to short sale price restrictions and asked whether this, the proposed bid test and the pilot program combine to sufficiently address the concerns that otherwise would be addressed by a hedging exemption from Rule 201.

The SIA has submitted a letter to the Commission commenting generally on many of the issues raised in the Proposing Release.³ In light of the Committee's focus, the Committee is submitting this letter separately to strongly recommend that the Commission adopt an exemption from proposed Rule 201 for hedging transactions. The Committee appreciates the Commission providing this opportunity for comment regarding these critical issues.

We Propose a Narrowly Drawn Exemption for Hedging Short Sales

The Committee believes that a hedging exemption from the uniform bid test is appropriate, necessary and consistent with the goals of proposed Regulation SHO and existing short sale regulation. We therefore urge that an exemption for hedging short sales be added to the uniform bid test in proposed Rule 201.

The exemption we propose would apply to short sales of securities that are effected by a broker-dealer or its affiliate,⁴ to hedge, in whole or in part, either (a) the broker-dealer's exposure to a derivative transaction entered into with a customer holding a long position in the underlying security or in a "Related Security," or (b) the broker-dealer's long position in that security (the "underlying security") or in a "Related Security," in each case so long as the long position has not been otherwise hedged at the time the short sales are effected. A "Related Security" would include any security (a) that is convertible into or exchangeable for, or the value, exercise, payout or settlement of which is linked to the value of, the underlying security, and (b) (i) the issuer of which is the issuer of the underlying security or (ii) that is eligible for trading on an established secondary trading market.

³ Letter to Mr. Jonathan G. Katz, Secretary, U.S. Securities and Exchange Commission, from George R. Kramer, Vice President and Acting General Counsel, Securities Industry Association, dated January 30, 2004 (the "SIA Letter"). The Committee affirms its support of the recommendations made in this letter.

⁴ The term "broker-dealer" as hereinafter used in this letter refers to a broker-dealer and any affiliate that directly or indirectly acts as a counterparty to a derivative entered into with the broker-dealer's customers.

Firms claiming the exemption would employ their formula-based risk management and pricing models to determine the appropriate number of shares to be sold short in establishing a hedge. These firms would be required to maintain and make available to the Commission for inspection appropriate internal monitoring systems designed to ensure that exempt hedging short sales are effected in compliance with these models. This will help to address the concerns the Commission has raised regarding surveillance of the exemption.

Initial Short Sales. Broker-dealers engage in two distinct types of hedging short sales: (i) the initial short sales to establish the hedge and (ii) dynamic adjustments during the time the broker-dealer holds the position being hedged.⁵ A broker-dealer that wishes to hedge a long derivative position through short sales of the underlying security will establish an initial hedge position by selling short the number of underlying shares determined by the broker-dealer's risk management and pricing models. The hedging exemption we propose would be available for such initial short sales.

Adjusting Hedges. Subsequent to establishing its initial short position, a hedging broker-dealer may need to dynamically adjust this position from time to time by effecting additional short sales and purchases of the underlying security. These additional transactions are necessary to respond to changes in certain market factors, such as the price, volatility and dividend rates of the stock and prevailing interest rates. For all the reasons set out in this letter, the Committee believes that such dynamic short sales would not give rise to the types of abuse that short sale price regulation is designed to address, and that it would be appropriate to exempt them from Rule 201's uniform bid test as well.

Dynamic adjustments may be required with varying degrees of frequency, sometimes over extended periods of time. We believe that it would be appropriate to apply the hedging exemption to short sales to dynamically adjust existing hedges, and we are confident that regulators would be able to develop adequate methods to surveil such transactions. However, due to the differences between initial and dynamic hedges, we believe that the Commission should consider the exemption with respect to initial hedges independently from its consideration of the exemption with regard to dynamic adjustments.

Exemption Limited to Hedges of Otherwise Unhedged Long Positions. The proposed exemption would be limited to short sales effected to hedge long positions

⁵ For a detailed explanation of the difference between initial short sales and dynamic adjustments, see Letter dated May 22, 1997 from Goldman, Sachs & Co., J.P. Morgan Securities Inc., Morgan Stanley & Co. Incorporated and Salomon Brothers Inc. to Jonathan G. Katz, File No. S7-07-97, at 12-16 (available at <http://www.sec.gov/rules/proposed/s7797/maher1.htm>) (copy attached). (Copies of certain letters and releases referred to herein are being submitted electronically with this letter. References to such items will be noted as "copy attached").

that are not otherwise hedged. This limitation would reduce the possibility of abuse of the exemption by a person with a single long position, who otherwise might enter into putative hedging transactions with several broker-dealers, triggering multiple exempt short sales for speculative or manipulative purposes.⁶ The broker-dealer would be required to make an affirmative determination that its customer (or the broker-dealer itself in the case of short sales to hedge its own positions) had not previously entered into any other offsetting transaction with respect to the long position being hedged. This determination could be based on customer representations and warranties.

“Related Securities” Must Be Issuer Securities or Have an Established Secondary Trading Market. The proposed exemption would be available to broker-dealers for short sales made with respect to hedges of broker-dealer long positions in certain convertible, exchangeable or equity-linked securities, and hedges of derivatives entered into with customers holding such long positions, but only if such securities are either (i) issued by the issuer of the underlying security, or (ii) eligible for trading on an established secondary trading market. This is intended to permit hedging of convertible or exchangeable securities sold in capital raising transactions (e.g., warrants, convertible or exchangeable debt or preferred securities, mandatorily convertible or exchangeable securities, and forward purchase contracts).

Related Securities that have been issued by the issuer of the underlying security are generally issued in capital raising transactions and, like the underlying security, provide investors with direct economic exposure to the issuer. Accordingly, we believe that offsetting short sales to hedge positions in Related Securities should be exempt from the bid test.

Related Securities issued by third parties also provide investors with economic exposure to the issuer of the underlying stock. So long as this exposure is not otherwise hedged, offsetting short sales would not raise the concerns that short sale price regulation is intended to address. However, the exemption we propose would only be available for third party-issued Related Securities if they are traded on an established secondary trading market. This would exclude from the definition of Related Securities, individually negotiated over-the-counter transactions. An “established secondary trading market” would include any securities exchange, any electronic dealer quotation system or other quotation system such as that operated by Pink Sheets, LLC or a similar organization, or any marketplace or facility for

⁶ This limitation would be correlative to the Commission’s position with respect to the potential for abusive use of married puts as a part of trading strategies designed to evade the application of short sale rules. See SEC Interpretive Release: Commission Guidance on Rule 3b-3 and Married Put Transactions, Securities Exchange Act Release No. 48795 (November 17, 2003), 68 Fed. Reg. 65819 (November 21, 2003) (copy attached).

bringing together purchasers and sellers of securities, including the over-the-counter market for 144A securities.⁷

Illustrative Examples of Eligible Hedging Transactions

1. *Derivatives to Hedge Customer Long Positions.* Derivatives entered into with broker-dealers are commonly used by companies, pension plans and other institutional investors, individuals and other broker-dealers (each, a “customer”) to hedge the market risks of holding shares of portfolio or subsidiary stock or Related Securities. The types of transactions designed to achieve this end are many.⁸ In the case of a forward contract, for example, shares are sold by the shareholder to the broker-dealer at a fixed price or at a price determined by reference to the market price of the shares over a specified period of time or at the time of the broker-dealer’s payment to the shareholder pursuant to the contract. The number of shares to be delivered to the broker-dealer at maturity or settlement of the forward contract may be fixed, or may depend upon the price of the shares on a specific valuation date or dates and the application of a formula to that price. The shareholder is not required to deliver more than the aggregate number of shares underlying the forward contract to the broker-dealer in settlement of the contract. Similarly, in an option-based transaction, the shareholder may enter into one or more option transactions against a long position in a particular stock or stocks. For example, the shareholder could purchase a put option from, or write a call option to, the broker-dealer on the underlying shares, or enter into a transaction involving a combination of options. Whether structured as a forward or as an option, derivatives may be settled by physical settlement, cash settlement pursuant to a pre-determined formula based on a market price, or net physical settlement. Very often, the shareholder will agree to pledge up to the aggregate number of shares underlying the contract, to the broker-dealer, to secure the shareholder’s obligations.

The exemption we propose would be available for the short sales required to establish the broker-dealer’s initial hedge position, and also should be available to

⁷ The exemption we propose would extend to securities sold in public offerings registered under the Securities Act of 1933, as well as to securities sold to sophisticated investors in offerings exempt from registration under Rule 144A or Section 4(2), so long as the above tests were met.

⁸ For detailed discussions of certain forward contracts and other option-based contracts see Goldman, Sachs & Co., SEC Interpretive Letter (avail. Oct. 9, 2003) (relative to hedging of forward and option based contracts through short sales registered under the Securities Act of 1933) (available at <http://www.sec.gov/divisions/corpfin/cf-noaction/goldmansachs100903.htm>) (copy attached); and Goldman, Sachs & Co., SEC Interpretive Letter (avail. Dec. 20, 1999) (relating to hedging of prepaid forward contracts through short sales made under Rule 144 under the Securities Act of 1933), 1999 SEC No-Act. LEXIS 974 (copy attached).

dynamically adjust that hedge position with respect to hedging transactions involving a derivative between the broker-dealer and its customer of the types described above.⁹

2. *Short Sales to Hedge Long Positions Held by Broker-Dealers.* Broker-dealers may hold underlying securities or convertible, exchangeable, and equity-linked securities (which we refer to herein as “Related Securities”) as proprietary positions in connection with various hedging and arbitrage strategies. Because in these circumstances the broker-dealer has a long exposure to the underlying security or Related Security, hedging of these proprietary positions is no different in substance than hedging transactions done for customer facilitation purposes. In fact, because they are effected by and on behalf of a broker-dealer, they may be easier to self-monitor and surveil. Therefore, the exemption we propose would be available for such proprietary hedging transactions.¹⁰

Hedging Short Sales are Beneficial – not Detrimental – to the Market

The Committee believes that an exemption for short sales made in connection with bona fide hedging transactions is appropriate and consistent with the goals of short sale price regulation, because such sales do not involve the types of market behavior that short sale price regulation is intended to address. Rather, we believe that hedging transactions and the short sales they involve are beneficial to the marketplace generally.

According to the Commission, the detrimental effects of short selling that short sale price regulation is intended to address include:

“preventing short selling at successively lower prices, thus eliminating short selling as a tool for driving the market down [and] . . . preventing short sellers from accelerating a declining market by exhausting all remaining bids at one price level, causing successively lower prices to be established by long sellers.”¹¹

Short selling to hedge a long position is not a tool for driving the market down; it is a tool for risk management. Hedging short sales economically insulate a

⁹ Among some market participants, it is a common practice to wait until the initial hedge is established before executing final documentation relating to the transaction. To aid in self-monitoring and surveillance, the exemption we propose would be available only to the extent that either: (a) preliminary documentation is executed prior to the commencement of the short sales for which the exemption is claimed; or (b) the parties intend to execute documentation promptly following completion of the initial short sales.

¹⁰ The definition of “customer” for purposes of the exemption we propose includes another broker-dealer, and, we believe, should apply equally to hedging short sales by a broker-dealer for its own account.

¹¹ Proposing Release, 68 Fed. Reg. at 62974.

long position from losses resulting from drops in the market price. In fact, in many cases, a critical factor in a customer's selection of a broker-dealer to effect a hedging transaction is the broker-dealer's commitment and ability to effect the hedging transactions with minimal impact on the price of the security being hedged. Unlike a speculative short selling strategy, the success of which depends on a downward move in security prices, a hedging short selling strategy will be successful only to the extent that the short sales are effected with minimum impact on the current price of the security being hedged. Hedging short sales are not effected to exhaust all bids at one price level. The number of shares of a security to be shorted in a successful hedging strategy is a function of the size and nature of the position being hedged and is not dependent on the amount of demand for the security at any price level.

As a risk management tool, hedging short sales provide significant benefits to the marketplace. Most obviously, they can insulate companies and investors from catastrophic losses. By reducing the vulnerability of market participants to fluctuations in market prices, the financial system as a whole may become more resilient to business cycle fluctuations and normal market volatility. For example, a corporate pension planner with a long-term equity position who is concerned about a temporary correction in the stock market can synthetically reduce his or her equity exposure by entering into a hedging transaction with a broker-dealer that in turn effects hedging short sales, usually at a lower cost and with less market impact than if the plan actually sold stocks.

Failure to Adopt a Hedging Exemption Will Threaten the Existing Hedging Market

The Committee believes that a hedging exemption is necessary because the proposed pilot program, security futures trading and the proposed uniform bid test will not, even in combination, provide sufficient flexibility or liquidity to effect short sales to hedge long exposure. Moreover, we are concerned that the adoption of a uniform bid test that does not include a hedging exemption could seriously threaten the existing U.S. market in hedging transactions.

The Committee recognizes that the proposed pilot program will provide – as to those issuers that are part of the pilot program – an exemption from the bid test for all transactions in the issuer's securities, including hedging short sales. The pilot program will only be available, however, for approximately 300 stocks (none of which has yet been determined). This will do nothing to address the concerns raised in this letter with regard to any security not covered by the pilot program and therefore does not provide a reliable basis on which a broker-dealer may operate a hedging business.

The Commission notes that “the absence of short sale regulation for securities futures may make trading security futures an attractive hedging alternative to equities.”¹² The Committee recognizes that in theory security futures could provide an adequate means of hedging certain long positions, yet this is not a realistic solution. Trading in security futures is in its infancy, and it is highly uncertain whether and when trading will develop to the point where there will be available security futures contracts to provide an adequate hedge for any particular security. Further, if trading in security futures were a complete substitute for trading in the cash markets, then it obviously would be pointless to regulate short selling in the cash markets when short selling in futures is unregulated.

The Committee does not believe that the proposed uniform bid test will provide sufficient flexibility to allow hedging of long positions. Under proposed Rule 201, a short seller may only sell short at a price that is one penny above the best bid. Therefore, during a declining market, the short seller is unable to “hit” any bid, but must wait for a buyer to “lift” its offer. Effectively, the short seller could be entirely locked out of making any short sales in a declining market – even where such short sales are not speculative or intended to profit from the decline, but simply to hedge a long position against losses as a result of that decline. Particularly where a hedging transaction has been priced on the broker-dealer’s risk bid, this risk of “lock-out” during declining markets significantly amplifies the market risks and costs of the transaction, which may render the transaction entirely uneconomic. Thus, the Committee believes that the proposed uniform bid test will unnecessarily introduce significant economic inefficiencies into proposed hedging transactions.

The Hedging Exemption We Propose is Consistent with Existing Exemptions

The exemption we propose is consistent with existing exemptions that address “specific situations that [do] not appear to present the opportunity for abuse that the Rule was designed to prevent.”¹³ For example, under Rules 10a-1(e)(7) and (8), short sales in connection with bona fide arbitrage transactions designed to profit from a current difference between the price of a convertible security and the underlying common stock, and those designed to profit from a difference between the price of a security in the United States and its price overseas, are exempt. There are identical exemptions from the current NASD bid test. The underlying policy rationale for these exemptions is that the two related transactions result in economically neutral positions, and thus do not present any incentive to manipulate the market.¹⁴

¹² *Id.* at 63004.

¹³ Concept Release on Short Sales, Securities Exchange Act Release No. 42037 (October 20, 1999), 64 Fed. Reg. 57996 (October 28, 1999) (the “Concept Release”), at 57998 (footnote omitted) (copy attached).

¹⁴ *See id.* at 58001.

Similarly, Rule 10a-1(e)(13) (the “Block Exemption”) provides that a broker-dealer selling securities that it acquired as a block positioner may disregard, in determining whether it is net long or net short,¹⁵ proprietary short positions that are the subject of one or more offsetting positions created in the course of bona fide arbitrage, risk arbitrage or bona fide hedging.¹⁶ Likewise, the Commission provided no-action relief from the uptick rule for sales by broker-dealers that are unwinding long index arbitrage positions, where the sale of stock was deemed a short sale solely because the broker-dealer elsewhere held short positions in the same securities.¹⁷ Again, the relief only applied to short positions established in the course of bona fide arbitrage, risk arbitrage or bona fide hedging activities, because such positions are economically neutral and the unwinding of the index arbitrage position was not viewed as involving the abusive short selling that Rule 10a-1 was designed to prevent.¹⁸ All of the foregoing exemptions are carried over with little modification to proposed Regulation SHO.¹⁹

Proprietary Risk Management and Pricing Models Will Permit Effective Surveillance

An important question raised in the Proposing Release is how a hedging exemption could be monitored so that it is not subject to abuse. First of all, the hedging exemption would apply only to hedging transactions. In determining the appropriate number of shares to be sold short, the broker-dealer would rely on its risk management and pricing models. Any broker-dealer wishing to rely on the hedging exemption for short sales would be required to implement systems, tailored to its particular businesses, systems and resources, reasonably designed to monitor whether

¹⁵ SEC Rule 3b-3, which defines the term “short sale,” provides that “a person shall be deemed to own securities only to the extent that he has a net long position in such securities.”

¹⁶ Application of Rule 10a-1 to Certain Sales by Block Positioners, Securities Exchange Act Release No. 20715 (March 6, 1984), 49 Fed. Reg. 9414, 9415 (March 13, 1984), 1984 SEC LEXIS 2063 (the “Block Exemption Release”) (“Where a separate short position . . . is fully hedged, and therefore economically neutral, there is no incentive to effect sales . . . in a manner that would cause or accelerate a decline in the market.”) (copy attached).

¹⁷ See Liquidation of Index Arbitrage Positions, Securities Exchange Act Release No. 27938 (April 23, 1990), 55 Fed. Reg. 17949 (April 30, 1990), 1990 SEC LEXIS 747 (copy attached).

¹⁸ In requesting the relief, Merrill Lynch (through counsel) stated that “under the circumstances, Merrill Lynch cannot benefit from any diminution in the price of the stock because any ‘gain’ in the short stock position . . . would be offset by a matching ‘loss’ in the long position maintained in the economic equivalent (*e.g.*, a convertible debenture or option). Thus, Merrill Lynch obviously would have no incentive to engage in ‘manipulative’ short sales to drive the stock price down.” Letter to Richard G. Ketchum, Director, Division of Market Regulation, from Andrew M. Klein, Schiff Hardin & Waite (October 2, 1986), 1986 SEC No-Act LEXIS 3010 (copy attached).

¹⁹ Proposed Rule 201 imposes certain additional conditions to the existing domestic arbitrage exemption contained in Rule 10a-1(e)(7), which the SIA has commented on separately in the SIA Letter.

the short sales had been executed within the parameters of the firm's risk management and pricing models. In the case of any discrepancies, the broker-dealer would investigate to determine whether any violations have occurred and, if so, what remedial action is required. It would seem reasonable to require any firm relying on the hedging exemption to mark relevant order tickets with a unique identifier, such as "Short Exempt – HE." Of course, such systems will require modifications to some broker-dealers' existing systems and may result in a delay before broker-dealers are positioned to claim the exemption.

The Commission previously has recognized that reliance on a broker-dealer's proprietary risk management and pricing models can be an appropriate basis for a hedging exemption, notwithstanding that these models involve an element of subjective judgment as to the volatility and other risk characteristics of a securities position. In 1992, the Commission described "bona fide hedging" in the context of the uptick rule by reference to the definition found in Section 11(a)(1)(D) of the Securities Exchange Act.²⁰ Recognizing that "the application of that term is largely a matter of custom and practice," the Commission earlier stated:

[W]hether particular combinations of stock positions and options positions result in risk reduction in each of the positions involves subjective judgments as to the volatility and risk characteristics of those positions. For example, "ratio" hedges are frequently used when the risk involved in a stock position is offset by the writing of options. . . . [S]ome industry participants use the "delta factor" derived from the Black-Scholes pricing formula; the delta factor predicts price movements in an option as a function of movements in the underlying stock. Other industry participants have developed their own models. The Commission recognizes that the calculation of volatility and risk can only be approximate, and believes that, for purposes of Section 11(a)(1)(D), *the determination of what constitutes an offset may be made by the use of any responsible method of calculating the risk of stock and options positions.*²¹

The broker-dealer's risk management and pricing models, and its systems and procedures to monitor whether short sales had been executed within the parameters of those models, would of course be subject to surveillance by the Commission. This type of surveillance is not new to the Commission. For example, the Commission

²⁰ See Securities Exchange Act Release No. 30772 (June 3, 1992), 57 Fed. Reg. 24415, 24419-20 & n.53 (June 9, 1992) (copy attached); see also Block Exemption Release, 49 Fed. Reg. at 9415.

²¹ Securities Exchange Act Release No. 15533 (January 29, 1979), 44 Fed. Reg. 6084, 6090 & n.58 (January 31, 1979), 1979 SEC LEXIS 2244 (emphasis added) (copy attached).

permits registered OTC derivatives dealers to determine their capital requirements for certain positions pursuant to risk management and pricing models approved by the Commission under Securities Exchange Act Rule 15c3-1(a)(5) and Appendix F thereto. In approving such risk-based capital models (and the OTC derivatives dealer registration process more generally), the Commission undertakes an extensive review of the internal pricing and risk management models and procedures of OTC derivatives dealers, including those models and procedures used in hedging transactions. The Commission also audits each OTC derivatives dealer on an annual basis.

In the Rule 15c3-1(a)(5) adopting release, the Commission encouraged the NASD “to recognize as ‘hedged’ those OTC option positions of an OTC derivatives dealer that are hedged on a delta neutral basis,” in order to permit OTC derivatives dealers to use portfolio risk management techniques.²² The Commission went on to encourage the NASD and options exchanges to recognize delta neutral hedges for both listed and OTC options.²³ Likewise, we believe the Commission should recognize that the hedging of options and other derivatives positions on an underlying security or Related Security, through the use of short sales designed to result in a delta neutral position, is critical to those same risk management techniques, and that such short sales should be exempt from the proposed uniform bid test.

In addition, the Commission and the SROs have and will continue to develop sufficient capability to surveil for misuse of the exemption. Indeed, in proposing the pilot program, the Commission declares that “the Commission and SROs now have access to a wide range of trading data on potentially manipulative trading behavior [which] greatly enhances the ability of the Commission and the SROs to monitor trading behavior . . . for manipulative short selling.”²⁴

Conclusion

The Committee believes that a hedging exemption from the uniform bid test is appropriate, necessary and consistent with the goals of proposed Regulation SHO and existing exemptions to current short sale regulation. We believe that an exemption narrowly drawn along the lines that we have proposed would be subject to effective self-monitoring by broker-dealers and surveillance by the Commission.

²² Securities Exchange Act Release No. 40594 (October 23, 1998), 63 Fed. Reg. 59361, 59380 (November 3, 1998).

²³ *Id.*, n.177.

²⁴ Proposing Release, 68 Fed. Reg. at 62983 (footnote omitted).

We thank the Commission for the opportunity to comment on these critically important issues. If there are any questions regarding the foregoing, or if the Commission would care to discuss this matter further, please contact the undersigned at (212) 538-2616, or Daniel N. Budofsky, Davis Polk & Wardwell ((212) 450-4907), Edward J. Johnsen, Katten Muchin Zavis Rosenman ((212) 940-8894), or Steven D. Lofchie, Davis Polk & Wardwell ((212) 450-4075).

Sincerely,

s/ Luke Farber

Luke Farber
Chairman, Derivative Products Committee

Attachments

cc: The Hon. William H. Donaldson, Chairman, SEC
The Hon. Paul S. Atkins, Commissioner, SEC
The Hon. Cynthia A. Glassman, Commissioner, SEC
The Hon. Harvey J. Goldschmid, Commissioner, SEC
The Hon. Roel C. Campos, Commissioner, SEC
Annette L. Nazareth, Director, SEC Division of Market Regulation
Robert L. D. Colby, Deputy Director, SEC Division of Market Regulation
Larry E. Bergmann, Associate Director, SEC Division of Market Regulation
James A. Brigagliano, Assistant Director, SEC Division of Market Regulation
Gregory J. Dumark, Special Counsel, SEC Division of Market Regulation
Kevin J. Campion, Special Counsel, SEC Division of Market Regulation
Lillian S. Hagen, Special Counsel, SEC Division of Market Regulation
Elizabeth A. Sandoe, Special Counsel, SEC Division of Market Regulation
Marla O. Chidsey, Special Counsel, SEC Division of Market Regulation
Lawrence E. Harris, Chief Economist, SEC
Stephen L. Williams, Economist, SEC Division of Market Regulation
Alan L. Beller, Director, SEC Division of Corporation Finance
Giovanni P. Prezioso, General Counsel, SEC
Jerry Quinn, Securities Industry Association
Daniel N. Budofsky, Davis Polk & Wardwell
Edward J. Johnsen, Katten Muchin Zavis Rosenman
Steven D. Lofchie, Davis Polk & Wardwell