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Invested in America

January 19, 2011

Mary L. Schapiro
Chairman
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549

Re: Rule 201 of Regulation SHO: Concerns with the lack of exemptive relief for single-priced opening, reopening and closing transactions

Dear Chairman Schapiro:

The Securities Industry and Financial Markets Association ("SIFMA")[1] understands that NYSE Euronext[2] and The NASDAQ Stock Market LLC[3] submitted a letter (the "Exchanges' Letter") requesting that the Securities and Exchange Commission ("SEC" or "Commission") grant an exemption from Rule 201 of Regulation SHO under the Securities Exchange Act of 1934, as amended ("Exchange Act"), for single-priced opening, reopening and closing transactions ("single-priced transactions") executed on or through the facilities of the NYSE Exchanges or the NASDAQ Exchanges under their respective rules. Specifically, we understand that the Exchanges sought an exemption from Rule 201's "alternative uptick rule" (generally preventing the execution or display of short sale orders in a security at a price less than or equal to the security's current national best bid while the short sale "circuit breaker" is in effect for that security) for short sales executed as part of a single-priced transaction. While we understand that the Commission has chosen at this time not to grant the Exchanges' requested relief, SIFMA wanted to highlight in this letter certain unintended impacts on a security's opening and closing that we believe may result from this decision. SIFMA plans on analyzing this issue further after the alternative uptick rule becomes fully effective on February 28, 2011, and would appreciate the opportunity to petition the Commission for relief after such date.

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1 SIFMA brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association ("GFMA").

2 SIFMA understands that the letter was submitted by NYSE Euronext on behalf of New York Stock Exchange LLC ("NYSE"), NYSE Amex LLC ("NYSE Amex"), and NYSE Arca, Inc. ("NYSE Arca") (collectively, the "NYSE Exchanges").

3 SIFMA understands that the letter was submitted by The NASDAQ Stock Market LLC, NASDAQ OMX PHLX LLC and NASDAQ OMX BX LLC (collectively, the "NASDAQ Exchanges").

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We understand that the Exchanges' Letter described a variety of unintended consequences that could result from single-priced transactions being subject to the alternative uptick rule. SIFMA agrees with these concerns, and had previously highlighted to the staff in the Division of Trading and Markets, on October 16, 2010, certain additional concerns with not granting relief to the Exchanges and other trading centers, which are set forth in Appendix A.

In addition to all of the concerns discussed in the Exchanges' Letter and Appendix A, SIFMA firms fear that the lack of an exemption from the alternative uptick rule for single-priced transactions could negatively impact orderly markets by causing increased volatility and uncertainty around the opening and close, as well as potentially negatively affect investors, including small investors, who will be forced to pay higher prices than they otherwise would have. For example, under the normal closing process, if a buy imbalance exists, sell short orders are executed to offset the imbalance. Without relief for single-priced transactions, there likely will be situations in which short sale orders, which contribute to achieving the proper price equilibrium, are prevented from being executed because of Rule 201 (*i.e.*, the relevant security has tripped the Rule 201 circuit breaker and is subject to the alternative uptick rule). As such, if a high bid appears near the close, the Exchanges would not have the ability to execute short sale orders to offset the high bid, thereby preventing the closing auction from achieving the proper price equilibrium. To that end, there could be a situation in which, for example, a 100 share bid that is submitted near the close sets the price for a security that trades millions of shares per day. Because there will be uncertainty as to whether short sales may be included in the disseminated imbalance information, firms may not be able to rely on such information, creating uncertainty and volatility around the close, and overall increasing risk.

Firms believe that the absence of relief could be even more problematic in connection with the opening, in that there could be situations where a firm needs to effect a short sale at the opening, but would be unable to do so. For example, with respect to an expiration Friday, a firm could need to sell short a basket of securities at the opening price, as part of hedging positions or unwinding hedging positions, established in connection with its market making activities. It is not uncommon for the opening price to be at or below the national best bid, based on the fact that the trade-through provisions of Regulation NMS do not apply at such time, and because certain stale quotes from secondary markets may exist right up until the open (*i.e.*, these quotes get ignored and are carried over leading up to the official opening). Especially in high volatility situations where conceivably hundreds of securities may be subject to the alternative uptick rule, if any of the securities in the basket were subject to the alternative uptick rule, then the short sale could not be effected if the price of the transaction (*i.e.*, the opening price) is at or below the national best bid. This could make it much more difficult for market participants to maintain an orderly and efficient market on options and futures expiration dates.

While we understand that this issue would not routinely be a significant detriment for stocks at expiration in the S&P 500 Index, it bears the potential to be significant on high volatility days. Moreover, it will more routinely be a significant detriment with respect to the stocks in the Russell 2000 Index. For example, a SIFMA member firm performed an analysis of the impact Rule 201 would have had on the May 2010 expiration Friday opening if Rule 201 had been in effect at such time. The firm concluded that approximately 139 stocks in the Russell

2000 Index would have been subject to the alternative uptick rule on that Friday morning. The firm then analyzed quotes at the opening for approximately 70 of those approximately 139 stocks (the approximately 70 with the largest percentage price drops). The analysis involved determining which of those stocks opened on the primary market at a price at or below the then current national best bid. The firm found that approximately 26 (approximately 37%) of those stocks opened that Friday at a price at or below the national best bid. Thus, Rule 201 would have prevented short sales in those securities from being effected on the primary market at the opening price. While the firm presumes that the normal rate for such occurrences will be less than what was experienced on that day, the associated risks will make it generally more difficult for market participants to maintain an orderly market on options and futures expiration dates and will also make options and futures trading more expensive for customers going forward.

While we understand that the Exchanges may be able to re-program their systems to apply the alternative uptick rule to single-priced transactions, it is important to note that the Exchanges will not bear the risk associated with the SEC's decision. Rather, the risk, including the costs associated with the risk, will be passed on to customers, including small investors, who will likely be forced to pay higher prices than they otherwise would have. Furthermore, we understand the Exchanges will be using different guidelines to program their systems for single-priced transactions, which will cause inconsistencies in the market. Additionally, as of the date of this letter, we understand that firms have not yet been provided with the technical specifications necessary to program for the Exchanges' proposed handling of single-priced transactions. Once the Exchanges do provide this information, firms will be expected to follow suit. In this regard, firms need this information as soon as possible in order to adequately program and test such programming by February 28, 2011.

While we understand that perhaps the Commission's decision to not grant relief may be based on a fear that short sales could negatively impact opening and closing prices, we believe that trades occurring at, or matching, the opening and closing prints should have no destabilizing impact on the stock price. The SEC should seek to limit the instances when regulatory restrictions interfere with the price discovery and matching of liquidity that occurs at the opening and closing of the market. In this regard, we note that the SEC had previously granted relief from the former "uptick" rule, Rule 10a-1 under the Exchange Act, to allow requesting exchanges and broker-dealers to execute short sales in after-hours crossing sessions at a price that is equal to a security's closing price on the primary exchange.[4] We are unaware that such relief contributed to the depressing of opening and closing prices.

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4 *See* Securities Exchange Act Release No. 48709 (October 28, 2003), 68 FR 62972, 62988-62989 (November 6, 2003) (Regulation SHO Proposing Release, which identified the following exemptive letters that have been provided to certain exchanges and broker-dealers: Letter re: Off-Hours Trading by the Amex (August 5, 1991); Letter re: Operation of Off-Hours Trading by the NYSE (June 13, 1991); Letter re: Burlington Capital Markets (July 1, 2003); Letter re: Bear, Stearns & Co., Inc. (January 19, 1996); Letter re: AZX, Inc. (November 15, 1995); Letter re: Instinet Corporation Crossing Network (July 1, 1992); Letter re. Portfolio System for Institutional Trading (December 31, 1991)).

The foregoing, combined with the Exchanges' Letter and the points referenced in Appendix A, discuss the primary unintended consequences that SIFMA believes could occur as a result of not granting the requested relief. We would be happy to discuss these concerns further with you, as well as certain other potential unintended consequences. We appreciate your time and attention to this important matter, and the opportunity to raise this issue for your consideration again after February 28, 2011. If you have any questions, please do not hesitate to contact the undersigned at (202) 962-7300.

Sincerely,

/s/ Ann L. Vlcek

Ann L. Vlcek
Managing Director &
Associate General Counsel

cc: Luis Aguilar, Commissioner
Kathleen Casey, Commissioner
Troy Paredes, Commissioner
Elisse Walter, Commissioner
Robert Cook, Director, Division of Trading and Markets
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Josephine Tao, Assistant Director, Division of Trading and Markets

APPENDIX A

Other Concerns Previously Highlighted to SEC Staff
in the Division of Trading and Markets in October 2010

- Inability to Match Buyers and Sellers at Opening, Reopening or Closing Price. Assume that a broker-dealer receives both a buy order and a sell order from two different clients who wish to execute at the closing auction price. The broker-dealer would like to be able to cross the two orders and principally fill any imbalance between the two. If the alternative uptick rule goes into effect, and the closing price is below the current bid after the close, then the broker-dealer will have no way to execute this cross and/or provide a principal fill if one side is short. This will thereby result in higher costs, thus disadvantaging investors. Routing the orders to the NYSE or NASDAQ is not an option as these exchanges do not guarantee that the orders will be executed and there are restrictions in terms of cut-off times for sending the orders to them. The absence of an exemption for single-priced transactions will hinder broker-dealers from performing one of their primary functions, providing capital to the market which in turn mitigates risk and softens market impact. Additionally, this situation could also arise where a broker-dealer does not wish to match a buyer and a seller, but simply facilitate a buyer by guaranteeing an opening, reopening or closing price.

- Guaranteed Open Orders. Equity index futures expire to a value determined by the opening price of all the underlying stocks on the third Friday of the expiring month. Any customer that trades index futures may need to execute an index basket at the opening price, and broker-dealers act as trading centers to help provide the liquidity to satisfy these customer orders. If no relief is granted for guaranteed open orders, then clients will be unable to go into an expiry with a large long futures position if they may need to sell short a stock that has become subject to the Rule 201 circuit breaker. For example, if a client needs to hedge their ESZ (S&P 500 December CME E-Mini futures contract) futures exposure going into expiry, the client may need to sell stock short at the opening price. A broker-dealer may accept the customer order and guarantee the client the opening price. But, assume one or more of the names in the underlying basket (S&P 500) has tripped the Rule 201 circuit breaker and, after the open, the stock price goes up. Given that the client's futures position is benchmarked to the open, the client only wants the opening price but, without relief, the broker-dealer will be unable to fill the client's order.

- Guaranteed Close Orders. The case for guaranteed close orders is similar. All index and exchange-traded fund (“ETF”) rebalances are done at the closing print on the primary exchange on the date of the rebalance so that index clients (*e.g.,* mutual funds) can track the index or ETF. Also, it is market practice to use the closing prices as a benchmark when Exchange for Physical transactions are executed over the counter or hedge transactions are executed especially when an index basket of securities is involved in the hedge. On Friday, September 17, 2010, for example, the S&P 500 had a large rebalance that was effective using the closing, primary exchange prices on that date. If, for example, IBM stock had hit a circuit breaker on that Friday during the day and it could not be sold short at the closing price after the primary market closed, any index client would not have been able to be facilitated if the rebalance required selling IBM short. While SIFMA supports allowing such executions to occur on the NYSE and NASDAQ exchanges, SIFMA believes that such relief should be extended to other trading centers as well. At a minimum, facilitation of guaranteed close orders should be permitted above the closing price as opposed to above the national best bid. Otherwise, this could lead to reduced liquidity for customer short sale orders that are benchmarked to the closing price. Major rebalances in most indices occur only quarterly, but there are often small rebalances every week for corporate actions. For clients, these changes are managed by accessing the additional liquidity provided by broker-dealers. SIFMA notes that this issue may be of significant importance to retail investors investing in mutual funds due to the inability for mutual funds to do appropriate rebalances.