

17 June 2008

Nancy M. Morris
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: “Naked” Short Selling Anti-Fraud Rule—File No. S7-08-08

Dear Ms. Morris:

The CFA Institute Centre for Financial Market Integrity¹ is pleased to comment on the SEC’s rule proposal that addresses fails to deliver associated with “naked” short selling. While this practice generally is covered by existing anti-fraud rules, we support the Commission’s efforts to draw attention to abuses involved in short-selling. In light of the continuing problems this practice presents, however, we suggest that the Commission take a new approach to addressing this issue.

Comments

In general, we support efforts by the Commission to curtail naked short selling, for all the reasons noted in the release relating to the detrimental effects on the marketplace. As noted, this practice not only affects shareowners by depriving them of the basic benefits of ownership, it also may detrimentally affect the issuer’s reputation and subvert the appropriate workings of the market by avoiding certain restrictions applicable to those who deliver on time. All of these issues can ultimately undermine investor confidence.

We find it curious, however, that the Commission is revisiting efforts to address naked short selling through proposing a new rule. As noted in the release, this practice is already prohibited under general anti-fraud rules. Moreover, Regulation SHO was proposed and enacted in part to address the problem of naked short selling. We question the need to adopt yet another rule aimed at eliminating this practice, particularly when this proposal does little more than reiterate the associated problems and create an anti-fraud rule for this specific conduct.

¹ The CFA Institute Centre for Financial Market Integrity is part of CFA Institute. With headquarters in Charlottesville, VA and regional offices in New York, Hong Kong, and London, CFA Institute is a global, not-for-profit professional association of more than 95,700 investment analysts, portfolio managers, investment advisors, and other investment professionals in 134 countries of whom more than 82,300 are holders of the Chartered Financial Analyst® (CFA®) designation. The CFA Institute membership also includes 135 member societies in 56 countries and territories.

Rule 203 of Regulation SHO allows a broker-dealer to satisfy its locate requirement by, among other things, having reasonable grounds to believe that the security can be borrowed so that it can be delivered by its due date. Amendments adopted in 2004 to Regulation SHO reaffirmed this reliance on customer assurances as long as the reliance is reasonable.

In this release, staff notes its concern that abusive short selling has continued. The release specifically notes that some short sellers may intentionally misrepresent to broker-dealers that they have a legitimate locate source or that they actually own the shares. The purpose is “an end run around Regulation SHO’s locate requirement.”

Proposed Rule 10b-21 seeks to remedy these problems by specifying that it is unlawful to deceive broker-dealers with respect to intentions or abilities to deliver securities by the date they are due. However, it still would allow the executing or order-entry broker-dealer to rely on customer assurances if they are deemed to be reasonable. Given the apparent persistence of naked short selling, we question the utility of creating a rule that holds a seller liable for misrepresentations in connection with short selling, while keeping in place a system that still allows a broker-dealer to reasonably rely on such assurances.

While we support elimination of naked short selling, we do not support the promulgation of yet another rule to address what Regulation SHO and the general securities laws have apparently failed to rectify. Instead, we recommend that the Commission reconsider its approach to addressing this issue. If general securities laws already cover fraudulent acts by a seller, the Commission already has the power to bring enforcement actions against sellers who act with an intention to deceive and should use those powers to halt these abuses.

In addition, we recommend that the Commission consider amending Regulation SHO to eliminate the regulatory “safe harbor” that allows broker-dealers to rely on the assurances of sellers. While broker-dealers may as a course of business be entitled to rely on reasonable representations, we question the necessity of a regulatory recognition that may appear to shift the burden of timely settlement, even if ever so slightly, from the broker-dealer. In addition, we suggest that the broker-dealer bear the ultimate burden of covering securities that fail to settle on time (or within a reasonably proscribed time-period after the date of delivery). We believe that through this clarification of responsibility, broker-dealers will more likely take the necessary steps to document or otherwise assure themselves of a true and reliable locate source.

Conclusion

Proposed Rule 10b-21 does little more than reiterate the problems related to naked short-selling, as originally framed in Regulation SHO and create specific liability for those who intentionally defraud. Given the apparent inability of Regulation SHO and the general anti-fraud rules to stem the flow of naked short-selling, we believe a new approach is warranted. We believe that this approach should focus on enforcing the existing anti-fraud rules against faulty sellers and move more responsibility for covering the securities that are not timely delivered onto the broker-dealers who are in a position to negotiate and document locate sources with the seller in such transactions.

We appreciate the Commission’s attempts to address the abuses of naked short selling through a narrowly tailored rule. However, we believe that addressing this practice through the creation of yet another rule is misplaced. Instead, we suggest refining the approach under existing rules that appear not to be working to better effect the desired result of severely reducing, if not eliminating, this practice.

We appreciate the opportunity to comment on proposed Rule 10b-21. If you have questions about any of the positions taken in this letter or would like additional information, please do not hesitate to contact Kurt Schacht at 212.756.7728 (kurt.schacht@cfainstitute.org) or Linda Rittenhouse at 434.951.5333 (linda.rittenhouse@cfainstitute.org).

Sincerely,

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