Goldman, Sachs & Co. | One New York Plaza | New York, New York 10004
Tel: 212-902-1000

Goldman Sachs

September 21, 2009

Elizabeth Murphy
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: Amendments to Regulation SHO: Reopening of Comment Period and Supplemental Request for Comment – File No. S7-08-09

Dear Ms. Murphy:

Goldman, Sachs & Co. and its affiliates ("Goldman Sachs") appreciate the opportunity to comment on the Commission's request for additional feedback on the proposed alternative price test, which would allow short selling only at a price above the current national best bid ("Alternative Uptick Rule").[1] We commend the Commission for its continued commitment to ensuring that all potential solutions are fairly considered in addressing this important issue and, in particular, the renewed request for data in support of arguments pertaining to the Alternative Uptick Rule and the other short sale price test proposals.[2] Our Original GS Comment Letter on the Commission's Original Proposing Release expressed our strong belief that a short sale price test will harm market efficiency and liquidity and will not be effective in further safeguarding the market against abusive short selling beyond those measures already undertaken by the Commission to address these concerns, such as Rule 204.[3] As we previously noted, if the Commission concludes that additional short sale regulation is warranted, there should be compelling data to demonstrate clearly that such regulations will achieve the Commission's goal of restoring investor confidence in our markets by preventing abusive short selling.

We continue to believe that the available evidence does not support the need for a short sale price test. In our review of the comment letters and other discussions relating to the short sale rule proposals, including the Commission's Roundtable in May 2009, we have not identified empirical evidence that would substantiate the need to adopt additional short sale regulation in the form of a price test, including the proposed Alternative Uptick Rule. In fact, the available empirical data suggests that short selling may benefit the market by exposing financial misconduct and aligning

[1] Exchange Act Release No. 60509, 74 FR 42033 (August 20, 2009) ("Supplemental Proposal").

[2] Exchange Act Release No. 59748, 74 FR 18042 (April 20, 2009) ("Original Proposing Release").

[3] Letter to Elizabeth Murphy, Secretary, SEC, from Paul M. Russo, Managing Director and Head of U.S. Equity Trading, Goldman, Sachs & Co. (June 19, 2009) ("Original GS Comment Letter").

market prices with fundamental analysis. As discussed in a recent study by professors at the University of Washington School of Business, short selling increased steadily in issuers during the several months prior to the initial public revelation of financial misrepresentation by such firms. This short interest was found to be positively related to the severity of a misrepresentation and higher in firms engaged in misrepresentations than other firms. The study did not find evidence that short selling resulted in downward price spirals when the misconduct is publicly revealed.[4] Similar to other empirical data cited by the Commission in the Original Proposing Release, the study calls into question the wisdom and efficacy of short sale price restrictions.

Various actions taken by the Commission over the past year have, in fact, reduced the potential for abusive short selling. Most recently, the Commission permanently adopted the requirements of Rule 204T, which strengthened the mandatory close-out requirements for fails-to-deliver resulting from sales of equity securities.[5] In contrast to the proposed price tests, the Commission's own economic analysis of the effect of Rule 204T clearly indicates that the rule resulted in a "significant downward trend in the number of fails to deliver..." and, thereby, had its intended effect on potentially abusive "naked" short selling.[6] As noted in the Original GS Comment Letter, changes to Exchange Act Rule 105, the adoption of Rule 10b-21 and information regarding short positions of institutional investment managers provided pursuant to temporary Rule 10a-3T gave the Commission unprecedented tools to address abusive short selling. In addition to these measures, there are continuing efforts to bring more transparency to short selling. Various self-regulatory organizations ("SROs") recently agreed to begin publishing additional statistics, including aggregate short sale volume by security and short sale transaction data for certain exchange-listed securities. Such information will enhance the ability of the industry, academics and the general public to assess the impact of short selling on pricing, liquidity and the overall health of our markets. We also commend the Commission on its decision to host a roundtable later this month that will address, among other topics, pre-borrowing, enhanced locate requirements and further transparency of short sales.[7] We urge the Commission to carefully consider its current short sale rules, comments from the roundtable and to study the SRO data before determining whether a price test is necessary in light of current market activity.

Although we continue in our strong belief that a short sale price test is unnecessary and will lessen the benefits of legitimate short selling, if the Commission concludes that a price test is warranted, then we would support a rule that is narrowly tailored to target those circumstances when a particular security may be most vulnerable to abusive short selling while not being so broad as to chill legitimate short selling activity that is neither harmful to the markets nor abusive. In our view, the test that would best achieve those goals (when compared with the other proposals) is a "circuit breaker" applied on an individual stock basis and that, when triggered, would apply the provisions of the Alternative Uptick Rule to short sales in those stocks whose price decline has tripped the applicable circuit breaker. We believe that any decline triggering an Alternative Uptick Rule circuit

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[4] Karpoff and Lou, Short Sellers and Financial Misconduct, University of Washington, Foster School of Business (Revised August 5, 2009), electronic copy available at: http://ssrn.com/abstract=1443361.

[5] Exchange Act Release No. 60388, 74 FR 38266 (July 31, 2009).

[6] Id.

[7] SEC News Digest (July 27, 2009).

breaker should be measured from the current day's opening price rather than the prior day's closing price. In addition, the appropriate threshold price decline should vary according to ranges established to reflect the differing trading characteristics of securities and, in that regard, we still believe that a 10%-20% price decline range is appropriate. Additionally, we continue to believe that any such circuit breaker test must include certain essential exceptions that allow for the continued execution of legitimate short sale transactions under circumstances that do not pose abusive concerns, such as in connection with bona fide market making activity or other activities that are not manipulative by their nature.

In addition to the foregoing, we also believe that the Alternative Uptick Rule, when triggered as part of a circuit breaker approach, should be enforced on a policies and procedures basis rather than by a strict prohibition. A policies and procedures-based approach will best reflect the complex and market data intensive nature of the rule and, accordingly, provide an approach to compliance that is both more practical and easier to implement and observe. We would note that the circuit breaker/ Alternative Uptick Rule would be easier to implement than other proposals provided that the Commission permits firms to leverage the numerous systems changes made to facilitate compliance with Regulation NMS (including the use of internal market data rather than consolidated data supplied by the industry plans).

Although easier to implement, an Alternative Uptick Rule would be more restrictive than the other short sale price tests proposed by the Commission and, as a result, the scope of activities and transactions appropriately exempted from the rule will be critical if the Commission is to avoid adversely impacting legitimate short selling and market quality. In particular, as we have previously stated, there must be an exemption for short sales effected as part of bona fide market making and hedging activity. Such an exemption should be available to liquidity providers that have obligations under SRO rules or that hold themselves out as willing to meet the capital needs of their clients and counterparties, including exchange market makers (including options market makers), OTC market makers, derivatives dealers, "authorized participants" engaged in the creation and redemption of ETFs, and upstairs facilitation desks meeting defined thresholds.[8]

Certain transactions that do not raise the risk of manipulative conduct also should be exempt from the Alternative Uptick Rule. Among other transactions noted in the Original Proposing Release and our Original GS Comment Letter, such exemptions should include "flickering bid transactions," VWAP and other benchmark trades; "Qualified Contingent Trades" and "Error Correction Trades" as defined in Regulation NMS guidance; and opening, reopening and closing transactions.[9]

The following sets forth our views on certain questions posed by the Commission with respect to the Alternative Uptick Rule:

- We do not believe that adoption of a short sale price test will have any lasting impact on investor confidence. Absent empirical data demonstrating the effectiveness of such rules on abusive short selling, any short term enhancement to investor confidence will be

[8] Although not part of the price test under former Exchange Act Rule 10a-1, an exemption for bona fide market making was a key part of the former NASDAQ bid test. The benefits to the market of such an exemption also have been recognized by foreign securities regulators. *See* Consultation Report on the Regulation of Short Selling, Technical Committee of the International Organization of Securities Commissions (March 2009).

[9] Original GS Comment Letter at 13-14.

negated when it becomes apparent that price tests do not meet the Commission's objectives or, more likely, adversely impact liquidity, pricing and the overall quality of the markets.

- The time and costs associated with implementation of the Alternative Uptick Rule would vary based on a number of factors. Required systems, policies and procedures and other changes would depend on the extent to which firms are permitted to use existing systems recently developed and implemented for Regulation NMS compliance. To the extent firms are required to implement new systems or procedures or override Regulation NMS routing or compliance systems to account for the Alternative Uptick Rule, implementation would be more difficult. Similarly, the number of exceptions and exemptions granted for purposes of compliance with a new rule also would factor into cost and time considerations. More details are required to determine whether new order marking, order routing or trade report modifiers would be necessary and, if so, the related time and costs of implementation. Under any circumstances, we believe that the two-month implementation period suggested in the Supplemental Proposal would be insufficient. To the extent that the Commission adopts any short sale price test, an extensive additional comment period should be afforded before effectiveness of the rule to permit firms to address the multitude of implementation issues likely to be raised by the specific requirements of any such rule.

Conclusion

Goldman Sachs appreciates the opportunity to comment on the Supplemental Proposal regarding the Alternative Uptick Rule and to reiterate and augment the comments expressed in our Original GS Comment Letter. We respectfully submit that, notwithstanding the understandable concern of all about the market events of the past year, there is no empirical basis for adopting a short sale price test as a means of effectively combating abusive short selling or bolstering investor confidence over the long term. By contrast, the Commission's recent efforts on this issue – most notably, the adoption of Rule 204 – have proven effective in addressing abusive short selling.

In the event the Commission determines to adopt a price test, we believe that a circuit breaker in combination with the Alternative Uptick Rule would be the least harmful approach, provided that it is narrowly targeted to minimize the potential impact on legitimate short selling. Finally, we reiterate, that if any price test is adopted, it is critical that the Commission grant exemptions for bona fide market making and other transactions that do not pose manipulative concerns.

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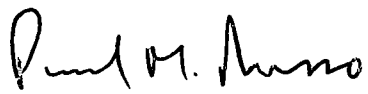
We commend the Commission for its continued focus on ensuring that additional rules in the area of short sale regulation are undertaken only after a thoughtful and deliberative process and are supported by substantial evidence that they will achieve their intended purpose. We look forward to working with the Commission on this issue. Please feel free to contact me with any questions that you may have on our comments.

Very truly yours,



Paul M. Russo
Managing Director
Head of U.S. Equity Trading
Goldman, Sachs & Co.

cc: Mary L. Schapiro, Chairman, SEC
Kathleen L. Casey, Commissioner, SEC
Louis A. Aguilar, Commissioner, SEC
Troy A. Paredes, Commissioner, SEC
Elise B. Walter, Commissioner, SEC
James Brigagliano, Acting Co-Director, SEC Division of Trading and Markets
Daniel Gallagher, Acting Co-Director, SEC Division of Trading and Markets
Jo Anne Swindler, Acting Associate Director, SEC Division of Trading and Markets