

that would only have to be programmed to consider a single test based on the consolidated best bid instead of two tests based on last sale and last bid information.

In addition, the degree of restrictiveness of a price test may affect how well the stock price represents fundamental values. For example, a flexible price test may allow a trader to more freely sell short a stock that he or she believes is overvalued. The Commission seeks comments on whether the proposed bid test would affect stock prices and whether proposed Rule 201 would result in prices that are a better reflection of the issuer's fundamental values.

The Commission seeks estimates and views regarding the benefits to particular types of market participants as well as any other costs or benefits that may result from the adoption of proposed Regulation SHO. Please provide any specific data.

Another potential benefit of the proposed bid test is that it should simplify surveillance systems in that proposed Rule 201 would look to the consolidated best bid at the time of execution as the reference price for short sales. This should be less complicated than comparing the immediately preceding sale or bid as the reference point for short sale compliance. In addition, we note that having only one short sale rule instead of two would mean that new staff (compliance personnel, traders, etc.) would only need to be trained regarding one rule. Over the long run, we believe this would likely lead to decreased costs for training and compliance.

The Commission received approximately 35 formal requests for relief from Rule 10a-1 in 2002 in addition to approximately 340 phone calls. The Commission anticipates that a large percentage of the relief requested would no longer be necessary under the proposed uniform bid test. We expect that each request for relief requires a number of labor hours from traders and lawyers, both in-house and outside counsel, of a broker-dealer or exchange, when making informal (phone calls) or formal (letters) requests for exemptions from Rule 10a-1. The Commission requests empirical data to quantify this benefit.

b. Costs

As an aid in evaluating costs and reductions in costs associated with the proposed Rule 201, the Commission requests the public's views and any supporting information regarding the costs associated with implementing the proposed uniform bid test. The

Commission believes that the proposed uniform bid test requiring short sales in exchange-listed and Nasdaq NMS securities to be effected at a price one cent above the consolidated best bid at the time of execution would impose costs on brokers or dealers, specialists, market makers, ECNs, Alternative Trading Systems (ATSS), and SROs. Adoption of the proposed uniform bid test in the various markets would require modifications to trading systems and surveillance systems. Under the proposal, systems trading exchange-listed securities and Nasdaq NMS securities would have to shift from Rule 10a-1's tick test and NASD Rule 3350's bid test, respectively, to the proposed uniform bid test. The Commission anticipates that these changes would result in immediate implementation costs associated with reprogramming trading and surveillance systems. One exchange informed us that reprogramming systems would take one month at a cost of approximately \$100,000. A broker-dealer stated that it would take two months to reconfigure its systems to account for a new bid test but was unable to provide a cost estimate. These estimates do not include costs associated with training staff that would be effected by these systems modifications.

The Commission seeks examples of all types of entities that would be affected by this proposal. The Commission seeks specific comments on the costs associated with system changes, including the type of system changes necessary and quantification of costs associated with changing the systems, including both start-up costs and maintenance. Comments are also requested on the types of jobs and staff that would be affected by systems modifications and training about the new rule, the number of labor hours that would be required to accomplish these matters, and the compensation rates of these staff members. The Commission also requests data to quantify the benefits of this proposal relating to ongoing compliance and surveillance of a uniform bid test. In addition, there may be costs associated with changing surveillance systems to monitor for compliance with the proposed bid test. We request specific comment on the costs for reprogramming systems to accommodate the proposed bid test in Rule 201.

2. Market Makers

a. Benefits

NASD Rule 3350 currently exempts from operation of the NASD's short sale rule short sales executed by qualified

market makers in connection with bona fide market making.²³³ We do not propose a market maker exception to Rule 201. We believe this would benefit the markets by subjecting all participants to the same regulation. We believe that the proposal would allow all market participants to establish short positions without being disadvantaged by an exception to the rule only available to certain participants. For example, there may be benefits in limiting the ability of a market maker to profit from position trading in anticipation of a market decline. The Commission also requests comment on any benefits that may result from adopting a price test absent a market maker exception. The Commission also seeks comments on the benefits of not allowing anyone to sell short at or below the best bid in a declining market.

b. Costs

The absence of a market maker exception from Rule 201 may have implications for market makers' ability to supply liquidity. Some may argue that investors are harmed when market makers incur an increase in costs because market makers would pass the increased costs to investors. The Commission requests detailed comments on these, or any other, costs to market makers, investors or others associated with not adopting an exception from the proposed bid test for market makers.

The Commission also recognizes that proposed Rule 201 may result in lost trading or business opportunities in the various markets. For example, there may be a cost in lost trading or business opportunities for those who trade Nasdaq NMS securities, in that the proposed bid test is more restrictive than the current Nasdaq bid test, and the market maker exemption has been eliminated. Please quantify, if possible, whether there would be any lost trading or business opportunity costs.

4. Use of the Consolidated Best Bid

a. Benefits

Proposed Regulation SHO would use the consolidated best bid as a reference point for all short sales of exchange-listed or Nasdaq NMS securities wherever traded. The Commission believes that the use of the consolidated best bid is a benefit because it reflects the consolidated bids from the various market centers that trade exchange-listed and Nasdaq NMS securities and is continuously collected and disseminated on a real-time basis, in a single stream of information and would

²³³ See *supra* part VIII for a further discussion.