

be a more accurate depiction of the market's valuation of a security.

#### b. Costs

The Commission is aware that this change may result in increased costs to traders, specialists, broker-dealers, and floor brokers on the NYSE or Amex who have heretofore used the last sale occurring in their own market as a reference point for short sales. For example, there would be a cost to market participants in gaining access to the consolidated best bid by subscribing to a vendor. We believe, however, that most, if not all, market participants already have access to this information. The Commission seeks information quantifying the cost of gaining access to the consolidated best bid.

In addition, it is possible that the consolidated best bid may flicker more than an exchange's own best bid. Bid flickering may impede on the ability to execute short sales, which may result in increased costs. Please provide data to assist the Commission quantify these costs, if any.

### 5. Marking Orders

#### a. Benefits

Proposed Rule 201 would permit broker-dealers to mark orders long only if the customer owns the securities and they are in the customer's account, or would be prior to settlement. Proposed Rule 201 also would require broker-dealers to differentiate between "long," "short," and "short exempt" sell orders. We believe these provisions would provide several benefits. The Commission notes that the current marking requirements can lead to undetected violations of proposed Rule 201 because once the order is marked "long," others handling the order execute the order as if it were a long sale, even though settlement on the sale may be effected by the delivery of borrowed securities. This can complicate surveillance for violations of the price test, as short sales executed under an exception from the price test can be masked as long sales. A benefit of this proposal is that surveillance for violations of proposed Rule 201 would be aided through accurate indications of when and under what circumstances these exceptions are utilized. An additional benefit is that the "short exempt" category would aid in surveillance for compliance with the proposed riskless principle exception to the bid test.

Further, we believe the proposed requirement that a broker-dealer cannot mark a sale "long" unless it has physical possession or control of the

security, either when the order is placed or prior to settlement, is a benefit because it would facilitate the process of clearance and settlement. Disturbances in settlement processes can affect the stability and integrity of the financial system in general. Clearance and settlement systems are designed to preserve financial integrity and minimize the likelihood of systematic disturbances by instituting risk-management systems. Requiring a broker-dealer to have possession or control of the securities before it can mark an order long would assist in reducing settlement and credit risks.

The Commission proposes extending the marking requirements to all equity securities, including OTCBB and Pink Sheet securities. This proposal is designed to assist in surveillance for violations of the locate and delivery requirements proposed in Rule 203 of Regulation SHO.

#### b. Costs

The Commission does not currently believe any costs would arise from the proposed requirement that sell orders be marked long only if the securities to be sold are owned by the customer and either presently, or prior to settlement, in the customer's account. Most customer securities are not held by investors in physical form, but rather are held indirectly through their broker-dealer, *i.e.*, in "street name."

The Commission anticipates that any costs arising from the proposed requirement that certain sell orders be marked "short exempt" would be minimal because some self-regulatory organizations already either require or advise members to utilize the "short exempt" designation. We believe that the Commission's proposed amendment codifies current practice and provides the markets with a uniform practice. The Commission proposes extending the marking requirements to all equity securities, including OTCBB and Pink Sheet securities. The Commission recognizes that there is a paperwork burden cost associated with adding the "short exempt" category and extending the marking requirement to all equity securities. As discussed above in Section XVIII, the paperwork burden is estimated at approximately 24 burden hours for each broker-dealer registered with the Commission.<sup>234</sup> The Commission does not believe there are any additional costs to this proposal,

however we seek any data supporting any additional costs not mentioned.

### 6. Exceptions to the Rule

#### a. Benefits

Proposed Regulation SHO would eliminate or alter exceptions to Rule 10a-1's tick test and create certain exceptions to the proposed bid test, which we believe would result in benefits. Proposed Regulation SHO proposes eliminating the equalizing exception, which is based on the last sale concept and would have no utility under the proposed bid test. This would further the goal of regulatory simplification.

In addition, the Commission believes that extension of the odd-lot exception to all market makers may reduce market makers' costs, since they would no longer need to register as odd-lot dealers or third market makers to avail themselves of the exception. Moreover permitting market makers to offset customer odd-lot orders and liquidate odd-lot positions without regard to the proposed uniform bid test would enhance market makers' ability to provide liquidity. To the extent that the benefits flowing from this increased liquidity can be quantified, we seek data and analysis on how to represent them accurately.

Moreover, the benefit of the proposal to alter Rule 10a-1's domestic arbitrage exception to require that a person relying on the exception must subsequently acquire or purchase the security upon which the arbitrage is based is that it would help reduce pricing disparities between securities. In addition, the proposed language change would help with surveillance for compliance with the exception.

In addition, the proposed limited exception to the bid test when the market is locked or crossed is beneficial because it increases liquidity by giving responsible broker-dealers flexibility to execute short sales in such situations. Moreover, the proposed exception permitting broker-dealers to sell short at the consolidated best bid to satisfy any obligations of a broker-dealer to customer limit orders, as determined by federal securities laws or rules of a self-regulatory organization, is a benefit because it ensures that customer limit orders are executed in a fair manner and at prices similar to the price at which a firm has traded for its own account. Finally, the proposed exception relating to pre-opening VWAP short sales would codify existing exemptive relief, thus providing the benefit of regulatory simplification, and may also promote a more liquid market for large traders.

<sup>234</sup> For a full discussion of the paperwork burden associated with the marking requirements see Section XVIII.