ES159205

James F. Getz
Chairman & Chief Executive Officer

The Hon. Jay Clayton
Chairman
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

May 7, 2020

Dear Chairman Clayton:

The purpose of this letter is to request that the U.S. Securities and Exchange Commission (the "Commission") take action to more effectively regulate computerized high-frequency trading and to reinstate the "uptick rule" to replace the "alternative uptick rule" currently in effect under Rule 201 of Regulation SHO. High-frequency trading ("HFT") and the largely ineffective alternative uptick rule have together led to outsized swings in the market that do not reflect economic fundamentals.[1] Instead, the combination of HFT and limited and ineffective regulation of short selling have resulted in significant negative impacts on business development and capital formation – especially equity capital formation - for small and mid-cap public companies, including banks, during the COVID-19 global pandemic and resulting economic crisis. This has adversely affected these companies when they need access to capital the most – and as stated in federal government support programs and regulatory guidance provided to banks – when the country needs them the most.

Until its repeal in 2007, the uptick rule required that any short sale had to take place at a price that was higher than the last price. The alternative uptick rule was adopted in 2010, but only applies if the price of a security decreases by 10% or more from the security's closing price on the prior day. Despite the consideration that went into the adoption of the alternative uptick rule ten years ago, market conditions have changed significantly and indicate the alternative uptick rule is not fulfilling its goal to "prevent short selling, including potentially manipulative or abusive short selling, from driving down further the price of a security that has already experienced a significant intra-day price decline, and . . . facilitate the ability of long sellers to sell first upon such a decline."[2]

Abusive short selling has caused damage to the market by creating false signals in the marketplace about the financial health of companies, especially banks and other financial services companies that are critical to the country's efforts to battle the economic crisis triggered by the COVID-19 pandemic. By creating non-fundamentals-based momentum that leads to excessive volatility and underpricing of stocks, abusive short selling is hurting and driving away investors, threatening customer

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[1] Studies by Bershova and Rakhlin (2013) and Gao and Mizrach (2013) find that HFT is associated with increased intraday volatility. Kirilenko et al. (2011) conclude that HFTs did not trigger the 2010 Flash Crash, but that their responses to the unusually large selling pressure that day exacerbated market volatility.

[2] *Amendments to Regulation SHO,* SEC Rel. No. 34-61595 (Feb. 26, 2010), *available at* https://www.sec.gov/rules/final/2010/34-61595.pdf.

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relationships, preventing access to capital, demoralizing employees, and potentially dramatically impairing or even destroying otherwise productive and profitable companies. While the practice of short selling can serve a legitimate role, such as aiding in price discovery and increasing liquidity, short selling in a broadly declining market can create a pile-on effect that reduces liquidity.[3]

The ability to trade high volumes ahead of the broader market at light speed enables high frequency traders to implement strategies, such as short selling and front-running other investors, that are designed to prompt sharp price movements and then profit from the resulting short-term momentum that they created at the expense of other investors. HFT has resulted in significant volatility and non-fundamentals-based downward pressure on stock prices through "momentum" trading strategies intended to make profits from front-running investor trades. These practices not only cost retail and fundamental investors money on execution, but also undermine investor confidence by creating downward momentum, causing panic selling and generating even more opportunities for bad actors to profit from a short HFT strategy.

The speed at which HFT occurs allows traders employing an HFT strategy to submit or cancel orders before retail and other fundamental investors can understand or respond, which puts these investors at a significant structural disadvantage. These factors also cause substantial harm to public companies by eroding investor confidence and facilitating the destruction of shareholder value, thereby making it more difficult for companies to raise capital. The harm to small and mid-cap companies from these techniques is exacerbated because such companies typically have fewer shares outstanding and lower trading volumes, which makes it easier for HFT to create volatility and execute a momentum trading strategy.

HFT and short trading also undermine our nation's banking system and harm the ability of small and mid-cap banks to support the economy during the economic crisis created by the COVID-19 pandemic and response. As identified in nearly every government support program in connection with the COVID-19 pandemic, it is critical that small and mid-cap banks have access to capital to support the United States business environment. HFT is impairing the ability of small and mid-cap banks to raise common equity capital at a level that can increase their ability to support their customers, which primarily are small and mid-sized businesses that collectively employ tens of millions of American workers.

Our company, TriState Capital Holdings, Inc. ("TriState"), and many similarly situated bank holding companies have been adversely affected by these factors in recent months. Consider the following data for our common stock:

- Between January 22nd and February 7th, short volume in TriState's common stock increased 118%, to 51.2% of its daily trading volume, when earlier in the month it averaged less than 18% of daily trading volume. Fast trading over the same period increased from approximately 40% of daily trading to a peak of 53% on February 2nd. This period was the first time that we are aware that short trading and fast trading

[3] In this regard, the Commission's rulemaking eliminating the uptick rule relied on pilot data from a broadly appreciating market. *See Regulation SHO and Rule 10a-1*, SEC Rel. No. 34-55970 (June 28, 2007), at 12, *available at* *https://www.sec.gov/rules/final/2007/34-55970.pdf* (citing comment letter of Carl Giannone). When faced with the only broad-based market decline between the elimination of the uptick rule and the COVID-19 pandemic, the Commission took action to temporarily ban short selling. *See SEC Halts Short Selling of Financial Stocks to Protect Investors and Markets*, SEC Rel. No. 2008-211 (Sept. 19, 2008), *available at* https://www.sec.gov/news/press/2008/2008-211.htm.

comprised a significant percentage of our daily trading volume. The combination of short selling and fast trading drove TriState's stock price down 8.8% from $25.06 on January 22nd to as low as $22.80 on February 7th.

- Between March 6th and 18th, short volume in TriState's common stock increased to 54.1% of its daily trading volume, a significant increase from the historical level discussed in the prior paragraph and even from the March 2020 average of 36.0%. Over the same period, fast trading in TriState's common stock increased drastically, rising from approximately 38.4% of daily trading volume to a peak near 65% on March 13th. The total number of shares traded per day also increased dramatically from our average annual volume of 113,248 shares (as of March 5, 2020) to 211,200 shares on March 6th and 572,100 shares on March 18th. The combination of short selling and fast trading drove TriState's stock price down 58.3% from $18.22 on March 6th to as low as $7.59 on March 18th.

- We announced our earnings on April 21, 2020. Between April 16th and April 21st, short volume in TriState's common stock increased from 35.2% to 58.9% of its daily trading volume, a significant increase from the historical level discussed in the first paragraph and even from the March 2020 average of 36.0%. Over the same period, fast trading in TriState's common stock increased drastically, rising from approximately 38.4% of daily trading volume to a peak near 75% on April 21st. The total number of shares traded per day also increased dramatically over this period, with a volume of nearly 1.8 million shares on April 21st, when our stock price increased 36% before closing the day up 24%.

The stock activity and declining price noted above in February and March occurred despite the absence of any new negative information regarding TriState or its financial performance following the filing of its 2019 Annual Report on February 24, 2020, as its only announcements before the April 21st earnings announcement were a letter to stakeholders issued on March 19 highlighting its financial strength and a press release issued on March 26 noting that TriState had been named to S&P Global Market Intelligence's 2019 list of the 50 best-performing U.S. community banks of its size.[4] TriState believes that other financially sound, similarly sized bank holding companies suffered similar effects during this period.[5] Between December 31, 2019 and April 15, 2020, the Nasdaq Bank Index declined 40.5%, compared much more moderate declines of 29.0% for the Russell 2000 Index and 13.8% for the S&P 500.

In the face of aggressive and sustained HFT and short selling activity during the March to April time frame in particular, TriState's stock price continued to decline. This activity not only threatened all of our stakeholders, it also created an artificially low stock price that will be difficult to recover from. I believe TriState's experience indicates that the alternative uptick rule is inadequate for purposes of

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[4] Stakeholder Letter, Exhibit 99 to Current Report on Form 8-K (Mar. 19, 2020), *available at* https://www.sec.gov/Archives/edgar/data/1380846/000138084620000011/tscstakeholderletter2020.htm; Press Release, Exhibit 99 to Current Report on Form 8-K (Mar. 26, 200), *available at* https://www.sec.gov/Archives/edgar/data/1380846/000138084620000013/tsc-release03x26x2020ex99.htm.

[5] *Bets Against the Stock Market Rise to Highest Level in Years*, The Wall Street J. (Apr. 19, 2020), *available at* https://www.wsj.com/articles/bets-against-the-stock-market-rise-to-highest-level-in-years-11587288601.

curbing abusive short selling and HFT techniques, and that additional action by the Commission is necessary. This same opinion has been shared by a number of others and covered in recent articles. [6]

The Market has Significantly Changed Since the Adoption of the Alternative Uptick Rule

The market has significantly changed since the "alternative uptick rule" was adopted in 2010, and these changes highlight the importance of curbing downturns in the price of securities. Today, approximately 80% or more of the trades in the U.S. are due to HFT, with automated trades executed based on programmed instructions, most of which likely include market volatility as an input.[7] According to JPMorgan Chase & Co, more than $100 billion of selling during the week of February 23 was fueled by strategies using volatility as a central input in trading decisions and other systematic tactics.[8] When markets fall dramatically, as they did in February and March, HFT magnifies the market slump and fuels investor panic.

Recent downturns have also been exacerbated because the use of options has increased significantly since 2010. Assets in mutual funds and exchange-traded funds using options strategies have soared to $26 billion from about $10 billion since 2010.[9] This enhances volatility as entities that have sold put options have to dump shares to try to hedge their losses.[10] As stock prices fall, prices will continue to plummet as firms sell stock to hedge the put options they have sold. Reinstating the uptick rule would help soften the market's proclivity to spiral downwards.

The extreme volatility in the financial markets in connection with the COVID-19 pandemic has caused many investors to express concerns about market manipulation and abusive short selling driving stock prices to abnormally low levels. Spain, South Korea, Italy, and the United Kingdom have instituted restrictions on short selling for periods of time in response to the COVID-19 pandemic.[11] Others have

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[6] *Reinstating this old trading rule would help the market more than a rate cut, Leon Cooperman says*, CNBC (Mar. 1, 2020), *available at* https://www.cnbc.com/2020/03/01/leon-cooperman-reinstating-this-trading-rule-would-be-more-powerful-than-a-fed-rate-cut.html; Richard A. Hayne, *Request to Reinstitute the Uptick Rule*, SEC Rulemaking Petition 4-759 (Apr. 6, 2020), *available at* https://www.sec.gov/rules/petitions/2020/petn4-759.pdf; *Urban Outfitters CEO Urges SEC to reinstate Uptick Rule for Short Selling*, Wolters Kluwer (Apr. 14, 2020), *available at* http://business.cch.com/srd/EXCHANGESANDMARKETREGULATION—UrbanOutfittersCEOurgesSECtoreinstateuptickruleforshortselling(Apr142020).pdf.

[7] *Sell-offs could be down to machines that control 80% of the US stock market*, CNBC (Dec. 5, 2018), *available at* https://www.cnbc.com/2018/12/05/sell-offs-could-be-down-to-machines-that-control-80percent-of-us-stocks-fund-manager-says.html.

[8] *Why are Markets so Volatile? It's Not Just the Coronavirus*, The Wall Street J. (Mar. 16, 2020), *available at* https://www.wsj.com/articles/why-are-markets-so-volatile-its-not-just-the-coronavirus-11584393165.

[9] *Id.*

[10] *Id.* ("Data firm SqueezeMetrics estimates that for every percentage-point fall in stocks, trading firms need to sell $30 billion in stocks to hedge their stances.").

[11] *Countries Curb Short Selling to Stem Steep Market Drops*, The Wall Street J. (Mar. 13, 2020), *available at* https://www.wsj.com/articles/countries-curb-short-selling-to-stem-steep-market-drops-11584112007. The Chief Executive Officer of Euronext, which operates several stock exchanges in Europe, noted issuers were complaining that the short selling of stock in the current circumstances was not driven by hedging or liquidity, and was instead strictly speculative. See *European Regulators Extend Short-Selling Bans, Frustrating Investors*, The Wall Street J. (Apr. 16, 2020), *available at* https://www.wsj.com/articles/european-regulators-extend-short-selling-bans-frustrating-investors-11587046533.

called for a more measured approach by calling to instead reinstate the uptick rule.[12] The market is properly concerned about the impact of short selling and HFT and these issues cut to the core of the Commission's mission of maintaining fair, orderly and efficient markets. Reinstating the uptick rule and restricting abusive HFT practices would accomplish each of these objectives. Importantly, restoring investor confidence that markets would function in a fair and orderly manner, even during an economic downturn, should add depth and liquidity to the markets. This would also likely increase the number of companies that are willing to go public and, in so doing, entrust market regulation to keep the trading in their stock more fair and based on fundamentals than would be the case if they continued as privately owned companies.

The Circuit Breaker Should Be Eliminated from the Alternative Uptick Rule

The uptick rule should be reinstated as the alternative uptick rule has proven to be ineffective at the time when it was most critical for the market – when the overall market is in steep decline. The 10% circuit breaker, when triggered, prevents short selling for the rest of the trading day and the following trading day. Suspending short selling for a day and a half after the circuit breaker is triggered does not solve the problem of HFT-driven short selling. For example, despite the decline in TriState's stock price of 58.3% between March 6th and March 18th, short selling as a percent of daily trading volume on average was approximately 54.1%. The circuit breaker prevents the alternative uptick rule from having more than a small impact on short selling and does not prevent damage when the market is in an HFT-driven freefall over a multi-day period. In addition, the circuit breaker does not protect retail and other fundamental investors who are not aware of the abusive trading.[13]

Another concern of the 10% circuit breaker, particularly in a market downturn, is the so-called "magnet effect," which is when stock prices are drawn down to the circuit breaker trigger level as sellers rush to sell short before the circuit breaker kicks in. Undoubtedly, HFTs will rush to short sell a sharply declining stock to avoid being locked out when a stock trips the 10% breaker.[14] This feature may result in *increased* short selling, particularly in a market downturn. This magnet effect only exacerbates the negative impact of short selling on the stock prices of viable companies.

Banks are Key to the Response to the Economic Crisis

Banks and financial services companies are on the front line of fighting the economic destruction caused by the COVID-19 pandemic. Banks are in need of additional capital to provide additional loans to clients who need access to liquidity, to maintain stakeholder and depositor confidence, and to provide support in the event that some loans cannot be saved and become non-performing. At the same time that banks are working hard to support the economy, the abusive trading tactics of short sellers and HFT are impairing the ability of banks and financial services companies to access capital, harming these

[12] *Id.*

[13] The Commission stated, "Thus, we believe that the short sale price test restriction of Rule 201 is structured so that generally it will not be triggered for the majority of covered securities at any given time and, thereby, will not interfere with the provision of market benefits such as liquidity and price efficiency for those securities, including when prices in such securities are undergoing minimal downward price pressure or are stable or rising," when discussing the adoption of the final alternative uptick rule with a circuit breaker. *See* note 2, *supra.*

[14] *Market Makers See Great Opportunities in Short Sale Rules*, Financial Planning (Apr. 5, 2010), *available at* https://www.financial-planning.com/news/market-makers-see-great-opportunities-in-short-sale-rules.

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institutions as well as their clients and the overall economy. Capital impairment also results in the additional negative effect of causing customers of small and mid-cap banks to have unwarranted concerns regarding the solvency of these institutions, resulting in another shift of business to "too big to fail" banks. The reinstatement of the up-tick rule is necessary to avoid the unwarranted and destructive impact of the war that is being waged against small and mid-cap banks and financial services firms at a time in history when the country needs them the most.

Conclusion

I strongly urge the Commission to take action against HFT and to reinstate the uptick rule. Such a move will boost investor confidence, prevent the financial ruin of sound companies during a market downturn, and create a marketplace where stock prices better reflect the condition of a company, while also reducing market volatility. Action by the Commission to limit HFT and reinstate the uptick rule will protect long-term investors as well as businesses.

Thank you for your time and consideration.

Sincerely,

James F. Getz
Chairman and Chief Executive Officer
TriState Capital Holdings, Inc.

cc: The Hon. Hester M. Peirce, Commissioner
The Hon. Elad L. Roisman, Commissioner
The Hon. Allison Herren Lee, Commissioner
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