

Comments of William Aurilio, August 1, 2002 (File name: waurilio080102.htm)

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<http://www.sec.gov/rules/concept/s72499/waurilio080102.htm>

At the invitation of a staff member of the SEC, I am writing to convey some personal observations that, in my opinion, contribute to the overall public distrust of our market mechanisms. I am also attempting to pass this on to Harvey L. Pitt, Chairman of the United States Securities & Exchange Commission and would appreciate it if you could help in that regard.

### **SHORT SELLING ACTIVITY**

While selling short is a legitimate market strategy and, when conducted in accordance with the law, it may well serve a valid purpose for the investor. Some say that the preponderance of the illegal shorts are in the hands of offshore entities and beyond the control of our domestic regulators. However, it has been observed and reported by investigative reporters that there are examples of massive naked or uncovered shorts held by some of the most prestigious names in the financial industry. The example of which I speak is related to the over-the-counter stock known as JagNotes. CitiGroup has a customer's account where they are showing some six thousand three hundred shares when, in fact, the customer owns over 1.2MM shares; Paine Webber reportedly is unable to account for some two hundred fifty-two thousand shares; while Morgan Stanley can't seem to account for approximately five hundred thousand shares. All of the foregoing in the same issue, JagNotes. (see Forbes June 10, 2002, pp 46-48 by Brandon Cople)

Being somewhat conversant with the mechanics of the short sale transaction, I can only speculate on just how such a situation could possibly come to exist. Under normal circumstances the opposing side of the short sale, i.e. the buyer's brokerage house would be demanding delivery and, in the absence of a such delivery, would thereafter declare a `fail' followed by a `buy-in' for the account of the sell side so as to complete the transaction and provide their buyer with the securities for which he has paid. This does not appear to be the case here, hence, there must be another explanation for this apparent short with no constraints imposed against it.

### **MY EXPLANATION**

Operating under the assumption that the participants would normally follow the standard procedures concomitant with the short transaction, I can see only one explanation for the facts as outlined above and that is as follows:

When the brokerage house receives a buy order they do not go to the market to satisfy the trade but, instead, merely report to the customer that he has bought the security, when in fact there was no actual trade.

This leaves the customer with a phantom position and the brokerage house with an off book liability with no opposing broker to whom they must give an accounting. It also gives the brokerage house an interest free loan that, should the company go belly up, will require no closing transaction. Should this happen the interest free loan would, as a consequence, ripen into a windfall for the brokerage house and could conceivably inure to their benefit without incurring a tax. (No taxable event having been involved in the process.)

### **ILLEGAL SHORT TRADING BY OFFSHORE ENTITIES**

I have been informed that the SEC is unable to control the offshore entities that short securities in our domestic markets. A question I would ask as a response to that assertion is, "Through whom are these trades routed or placed?" Another question I have is, "How do these offshore entities get control of the money that flows from the trade?" And, "How do these people enter our markets without the complicity of one of our domestic brokers?"

### **THE NATURE OF THIS PRACTICE AND ITS CONSEQUENCES**

Pure and simple, the naked short is nothing less than a counterfeiting operation not even requiring a printing of a paper document. This creation of an unlimited supply of that particular security makes it virtually impossible for that security to achieve or maintain any semblance of stability in the market.

### **SUMMARY**

This problem is not limited to one or two isolated incidents or securities and is a major contributing factor in the current lack of confidence in the markets and the wholesale withdrawal of a large percentage of the public. In my opinion, our capital markets have already suffered extreme damage and, if these practices are allowed to go on unchecked, the viability of our markets will continue to be severely challenged. I see this as a threat to our national security.

There has been speculation that the practices alluded to herein have been used to acquire capital for some of the terrorist organizations. If so, not only are they achieving that objective but, in addition, they are doing severe damage to the capital markets in the United States which is the engine that drives our economy and from which derives our ability to finance our national defense.

### **COMMENT**

Toward the end of WWII the Germans were on the verge of flooding the British economy with massive amounts of 20£ notes, the object being two fold; one, to use the capital for purchase of war materiel, and two, to destroy confidence in the British economy. Their strategy could have worked, however, it was nowhere near as accurate and lethal as that which is being perpetrated against The United States, our capital markets and our citizens

who have already suffered irreparable damage and have had their personal security destroyed, their faith in the capitalist system shaken and their spirit eviscerated.

Just as the Treasury Department vigorously defends the currency of the United States against counterfeiters, so too should the Federal Government take strong action to protect and defend our capital markets and make secure the instruments that represent indicia of ownership.

Make no mistake, we are at war and, though we may prevail on the battlefield, we are losing the war on the financial front. So, in the final analysis, we may turn around to find that that which we have defended at the cost of many young lives has been stolen from us while we slept.

Thank you for this opportunity to express my concerns. I hope my comment provides some value in overcoming some of the challenges we face as nation.

Sincerely,

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