FAIRFAX
FINANCIAL HOLDINGS LIMITED

September 19, 2006

Ms. Nancy M. Morris
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Dear Ms. Morris:

Re: **Release Number 34-54154; File No. S7-12-06**
Comments on Proposed Amendments to Regulation SHO

We sincerely appreciate the efforts of the Securities and Exchange Commission (SEC or Commission), through its Proposed Amendments to Regulation SHO, to further curb the potential abuses of short selling while preserving the vital role that lawful short selling plays in the U.S. capital markets. As the SEC considers these amendments, we are pleased to respond to the Commission's invitation to the public to provide comments on its initiative to improve Regulation SHO.

Fairfax Background

Fairfax Financial Holdings Limited (Fairfax) is a financial services holding company which, through its subsidiaries, is engaged in property and casualty insurance and reinsurance, investment management and insurance claims management. As at June 30, 2006, Fairfax had total assets of $27.8 billion, including $15.8 billion in portfolio investments, and common shareholders' equity of $2.9 billion, and its revenue for the 12 months ending June 30, 2006 was over $6.5 billion. As at September 15, 2006, the market value of Fairfax's outstanding shares was $2.5 billion.

Fairfax has strong commercial and financial connections with the United States – more than 5,000 of our 8,000 employees work throughout the United States – and its capital markets – Fairfax's shares are listed on the New York Stock Exchange (NYSE), and close to half of our shares and almost all of our bonds are held in the United States.

Unfortunately, Fairfax has been continuously included on the NYSE's Threshold List since its inception (January 7, 2005), except for approximately two months in 2005. We have the unwelcome distinction of being the company currently on the NYSE Threshold List for the longest uninterrupted period of time (252 days).

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During the period for which we have been able to obtain fail-to-deliver (FTD) data for Fairfax shares[1], FTDs have averaged 356,934 shares. Fairfax's FTD position rose as high as 1,119,495 shares (May 4, 2005) and never fell below 10,015 (August 20, 2004). Fairfax FTDs stood at 345,630 on June 30, 2006.

Attached to this letter as Exhibit 1 is a chart illustrating the interrelationships among Fairfax FTDs, share price, short interest and option open interest since April 2004 (subject to data availability). For the last two years, Fairfax's short interest has remained above 2.1 million shares. The short interest is currently 4.6 million shares, an all-time high and double the level of a year ago. Exhibit 1 also shows that when Fairfax FTDs peaked in May 2005, the price of Fairfax shares was close to its 52-week low. Exhibit 2, a scatter plot, demonstrates that Fairfax's share price declined significantly with increases in Fairfax short interest.

We also find two statistically significant positive relationships involving Fairfax short interest as a percent of Fairfax's shares outstanding (short interest ratio). In particular: (1) during the 16 months from May 2005 through August 2006, Fairfax option open interest as a percent of shares outstanding increased significantly with the short interest ratio, and (2) during the 27 months from April 2004 through June 2006, Fairfax FTDs as a percent of shares outstanding increased significantly with the short interest ratio.

Comments on the SEC's Proposed Amendments to Regulation SHO

In our dual role as both a substantial investor in the U.S. capital markets (we manage the above-mentioned $15.8 billion of our insurance and reinsurance subsidiaries' portfolio investments) and as a publicly-owned company whose shares are traded on the New York Stock Exchange (in addition to Fairfax itself, one of our subsidiaries is also listed on the NYSE), we strongly support the SEC's proposed amendments to eliminate the "grandfather" exemption of Rule 203(b)(3)(i) and the SEC's proposed amendment to limit the duration of the "options market maker exception" in Rule 203(b)(3)(ii). The Commission has made a persuasive case for these much needed changes. In addition, we would like to suggest two additional measures which we believe would improve the effectiveness of short selling regulation:

1. Conduct a SEC study to determine whether and to what extent the "narrow" options market maker exception from the uniform "locate" requirement for short sales executed by market makers is being abused in a manner that is inconsistent with the express purpose and language of Rule 203(b)(2)(iii) of Regulation SHO; and

2. Provide investors and issuers with increased market transparency by requiring self regulatory organizations (SROs) or broker-dealers to disclose, on a daily basis, both the aggregate FTDs and the number and location of new FTDs with respect to shares of Threshold List companies.

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[1] Fairfax obtained FTD data in response to Freedom of Information Act (FOIA) requests. FTD data was obtained for 475 of the 561 days from April 12, 2004 through June 30, 2006. For 86 of the 561 trading days in the period covered by the FOIA requests, the data were reported "N.A.".

SEC Study of the Options Market Maker Exception

Regulation SHO, as adopted by the SEC in 2004, provides for a limited exception from the uniform "locate" requirements, as Rule 203(b)(2)(iii), for short sales executed by certain market makers, including options market makers. Regulation SHO provides that this exemption may be invoked only in connection "with bona fide market making activities." The rule interpretation goes on to state that "bona-fide market making does not include transactions whereby a market maker enters into an arrangement with another broker-dealer or customer in an attempt to use the market maker's exception for the purpose of avoiding compliance with [the uniform locate requirements] by the other broker-dealer or customer."[2]

Fairfax believes that its persistent presence on the NYSE Threshold List and the significant number of Fairfax FTDs results predominantly from the short sale of Fairfax shares (without any subsequent delivery of such shorted Fairfax shares) by options market makers. The SEC's proposed amendment to the duration of the options market maker exception improves upon the current regulation by requiring the reduction of certain FTDs within 13 days of the liquidation or expiration of the previously hedged option. However, this proposed amendment would continue to permit FTDs to persist for as long as the options that were hedged by short sales creating the FTD continue to exist, which for some option contracts could be one year, two years or longer.

Fairfax understands that the need to maintain liquidity in the capital markets, and in particular derivative markets, may necessitate some form of permitted hedging by options market makers. However, providing options market makers with continued access to free hedging for their option writing (by selling shares short without locating them), particularly in cases where shares are extremely expensive to borrow, has created a highly lucrative business for options market makers[3] that is susceptible to abuse and has the potential to have a significant detrimental impact on public companies and their shareholders.

The SEC recognizes that the scope and use of the options market marker exception raises serious questions under Regulation SHO. In the SEC's current release proposing amendments to Regulation SHO, the Commission seeks comment on more than a dozen issues relating to possible abuse of and further changes to, and even the elimination of, this controversial exception. Fairfax respectfully suggests that the SEC commence a study to look at how this exception is working in practice and what changes are needed to make sure that it is not subject to abuse.

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2 Securities Exchange Act release No. 50103 (July 28,2004), 69 FR 48008, 48015 (August 6, 2004)

3 Evans, Richard B., Christopher C. Geczy, David K. Muston and Adam V. Reed, "Failure *is* an Option: Impediments to Short Selling and Options Prices," December 7, 2005 working paper, document the abnormally high profits that are available to a large option market maker when shares are costly to borrow. The costlier it is to borrow shares, the more would-be short sellers are willing to pay for put options, which allow them to make negative bets without selling short. Market makers profit by selling the high-priced puts and hedging with short sales on which they fail to deliver because they are permitted to do so: a strategy not available to public investors.

Greater Transparency of Daily Failures to Deliver (FTDs)

Under Regulation SHO, special rules and restrictions apply to the securities of issuers that appear on Threshold Lists. Despite this fact, very little information is provided to market participants or issuers about the FTDs that cause issuers to be included on those lists. Some limited information is available through the Freedom of Information Act (FOIA); however, this process is time consuming and costly for all concerned and generally results in the production of stale information.

Fairfax respectfully suggests that Regulation SHO should require SROs or broker-dealers to disclose, on a daily basis, both aggregate and new FTDs, as well as the identities of the broker-dealers carrying such FTDs, with respect to Threshold List companies.

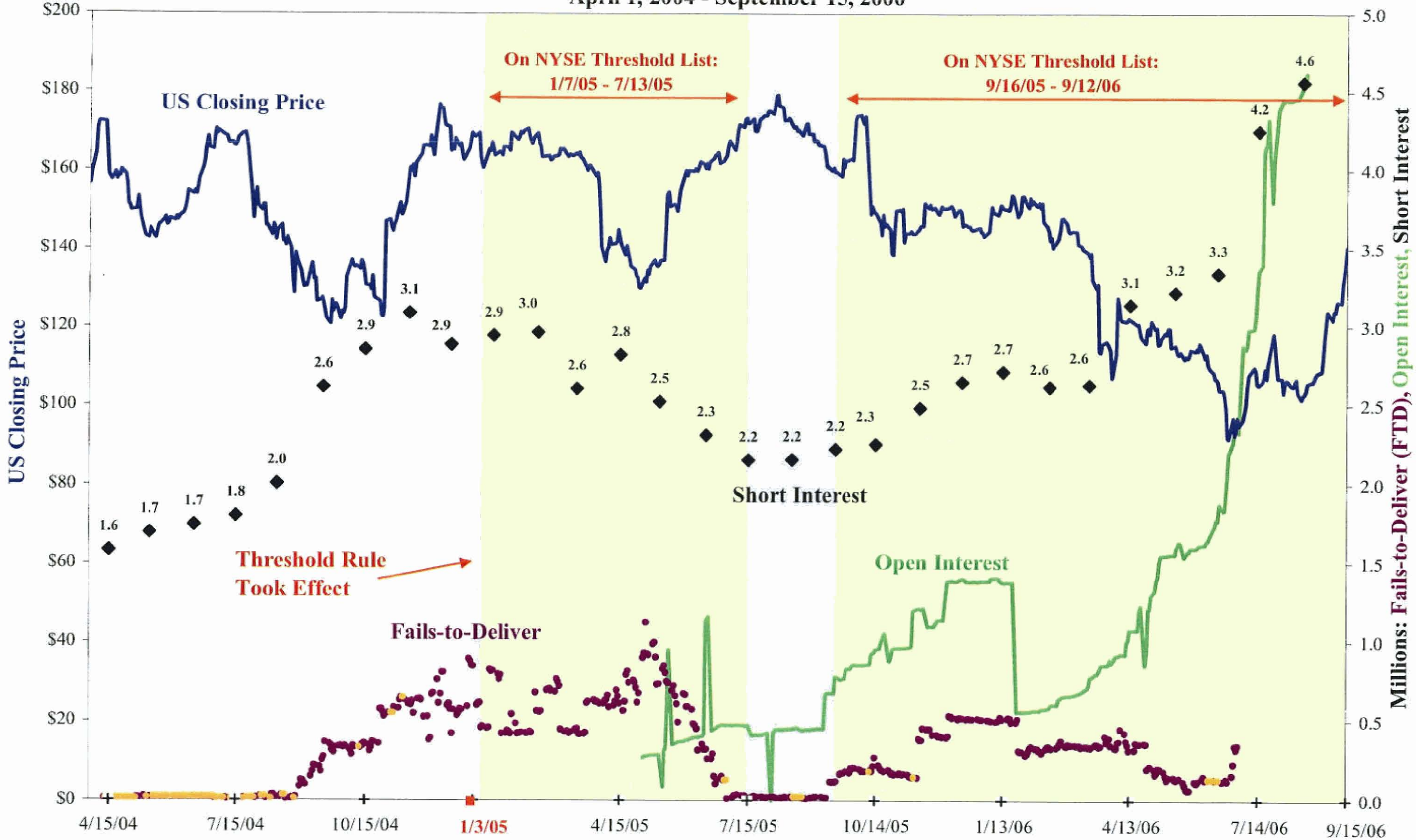
Thank you again for your time and effort to improve this important regulation.

Yours truly,

Paul Rivett
Vice President

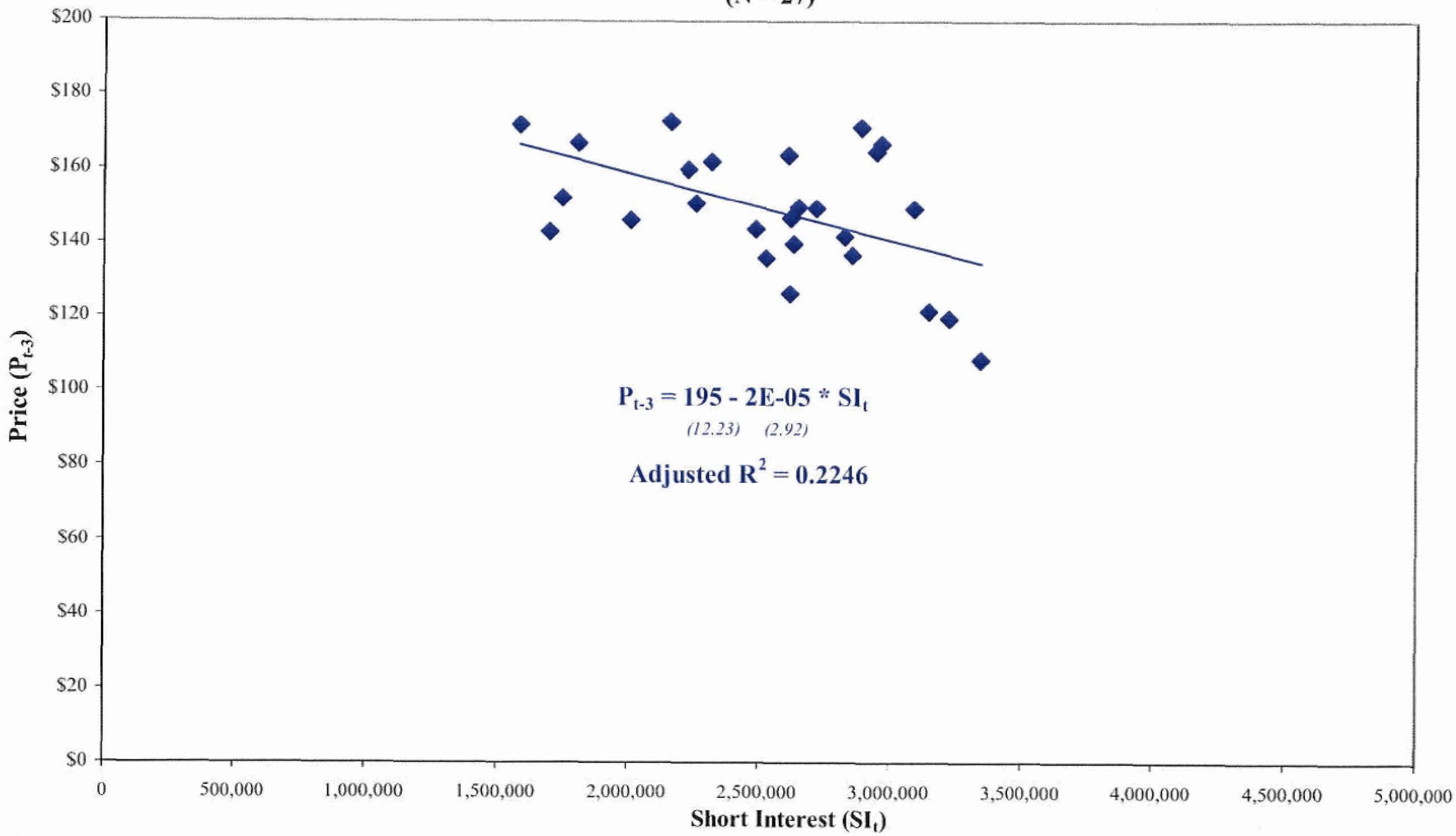
Enclosures

Exhibit 1
Fairfax Financial Holdings Limited
Daily US Closing Price, Fails-to-Deliver (FTD), Option Open Interest (Share-Equivalents) and Short Interest
April 1, 2004 - September 15, 2006



Notes and Sources:
Data on U.S. closing price are from FactSet Research Systems, Inc. Short interest data are from Bloomberg, LP. Option open interest data are from CBOE. Fails-to-deliver are provided to counsel by SEC under FOIA; first available fails-to-deliver is on 4/12/06 and last available fails-to-deliver is on 6/30/06. Fails-to-deliver reported as N/A on day t are treated as unchanged from day t-1 (orange dots on the graph).

Exhibit 2
Fairfax Financial Holdings Limited
U.S. Closing Price (P) Falls Significantly with Short Interest (SI)
April 15, 2004 through June 15, 2006 (Mid-month Data)
(N = 27)[1]



Notes and Sources:

U.S. and Canada short interest data are from Bloomberg LP. Data on U.S. closing price are from FactSet Research Systems, Inc.

The italicized number is the t-statistic. It must exceed 1.96 in absolute value for the relationship between the independent variable and the dependent variable to be statistically significant at the 5% level.

[1]Price is lagged 3 days to make it as of the last trading day relevant to SI.