Thank you for the opportunity to comment on Reg SHO and the proposed changes.

I agree with the elimination of the grandfathering provision. There is no good reason why a fail should be allowed for more than a year. But more importantly this should be changed so that it takes a disinformation weapon away from the hands of people who are pretending that this is a major issue facing our markets. Six months ago 99.2% of all grandfathered fails had been taken care of, and a whole lot more have been take care of since. Yet, the rhetoric about this pretends that this is a grave issue threatening the integrity of our markets. In fact, it is insignificant. You had asked for feedback on the number of days for the phase-in period. Since the number of shares here is inconsequential, I encourage you to make the phase-in requirement as short as Reg SHO's critics would like it to be.

Likewise, there is no particular reason for an options market-maker to be exempted from Reg SHO after the derivative has expired or been liquidated. Thus, please consider making this change as well.

Some of the other ideas, however, on which you solicited comments, would have significant deleterious market effects. The most significant of these is a change to the locate requirement. Currently lenders offer shares in the hope that they will be used. But once a trader has a locate, there is no obligation to put on the position. Thus, many, many locates expire unused. The financial reward to the lender occurs only if the locate turns into a borrow because the stock was actually shorted. The disincentive to the lender is that, if he over-lends, some trader will get bought in, and the subsequent ire will affect one of the lender's customers. Thus, the current situation works reasonably well, though in the case of stocks which have big intraday runs a higher percentage of locates will be transformed into borrows because the shares will actually be sold short. These do get bought in quickly (I speak from personal experience). If the rule changes into a pre-borrow requirement, then an artificially small number of shares will be available most of the time for short-selling. In addition, since the problem occurs almost exclusively with negative rebate stocks, there will be an additional disincentive to short-selling. It is exactly these high-volatility stocks with large upward moves where the virtues of short-selling to market efficiency are clearest. Thus, I would strongly recommend against changing the rule.

You also solicited input about shorting ETF's. Clearly the market benefits from the availability of ETF's and the concomitant hedging. Any restriction on shorting ETF's would not be in the interest of market efficiency nor liquidity. The fact that the QQQQ's were failing a year ago and came close to being a mandatory Reg SHO buy-in is absurd. Clearly it was nobody's intention to restrict this activity when Reg SHO was instituted. In answer to your question about whether there is something special about ETF's where the close-out requirements are inappropriate—yes, there is. ETF's are issued according to market demand. During periods of rapidly increasing demand, issuers may be slow in getting sufficient supply into the market. Thus, relaxed short-selling requirements to deal with temporary dislocations are an appropriate response (plus, short-selling ETF's is not a politically sensitive area).

In fact, it is appropriate now to review the political climate in which Reg SHO was initially instituted and to ensure that it is doing what should be done. In addressing the real issues behind the Regulation, I am going to call a spade a spade, and I apologize in advance if my bluntness offends anyone.

Reg SHO was initially instituted because of a pervasive belief that naked shorting was harming the markets by putting undue depressive pressure on certain stocks. This was a modern-day incarnation of the "bear raid" fear that has existed since the 1920's. No one disputes that, if such a thing were occurring, it would be injurious to companies and to the market. The questions are 1) how often does it occur, and 2) when it doesn't occur, who benefits from pretending it does.

Clearly shorting is a problem when there is a floorless or resettable convertible. Evidently brokers are/were accepting the convertible (perhaps with conversion instructions given?) as a long position, so the sale is seen by the broker as a long sale. In any event, the effect on a stock price is exactly what those people who agitated for Reg SHO were so concerned about: a relentlessly spiraling stock price which never recovers. Despite the fact that it has been clear for a decade what will happen if a company issues a floorless convertible, companies still issue these horribly dilutive convertibles. The only reason for this is that the company needs money to keep overpaying management at the expense of their shareholders.

Other than that, how often does naked short-selling occur? Outside of market-making, where it is both legal and desirable, the answer is "almost never". But that hasn't stopped people who have a vested interest in promoting the story from pretending it is a big issue. Part of the perception problem is that the Commission has been unwilling to address the issue and educate the public. Thus, the Commission has remained silent when promoters have blithely pretended that extended stays on the Reg SHO list is prima facie evidence of naked short-selling. The fact of the matter is that, if a stock is in sufficient borrowing demand, and, if there is enough trading (with the natural inability of any one brokerage house to see the entire outstanding supply), it is a certainty that the stock will stay on the Reg SHO list forever—legitimately. I have never seen the Commission detail this process. Take UALAQ last year. UALAQ was the equivalent of a winning lottery ticket since every serious investor knew it was going to 0. Let's say I was short 100,000 shares at Goldman. For simplicity's sake let's also say that Goldman's total box was 1,000,000 shares, that there were no outside borrows, and that Goldman holders were selling their shares on average 100,000 shares a day with an up and down variation of 50,000 shares a day. Because UALAQ was such a winner, the entire hypothecated float was shorted. So, let's take the hypothetical Goldman situation, and for simplicity's sake again posit a rhythmic variation where Goldman's box goes from 1,000,000 to 1,050,000 to 1,000,000 to 950,000 to 1,000,000 to 1,050,000, etc. Thus, on days 4, 8, 12, etc. Goldman will be failing. Likewise on days 2, 6, 10, 14, etc. Goldman will have an extra 50,000 shares available for shorting--shares which will be instantaneously snapped up by its customers. Thus, additionally the next day (days 3, 7, 11, 15, etc.), when the box goes down to 1,000,000, Goldman will fail again. And on the days when Goldman is not failing its counterparties will be failing. If a borrow is desirable enough, it will ALWAYS be constantly failing someplace, even though no more than the total hypothecated float will be shorted. So, with simple math it is a guarantee that a really desirable short will NEVER leave the SHO list. But I have yet to see the Commission describe how this works—leaving the discussion to people with a vested interest addressing others who have never shorted a stock in their lives.

It is not surprising that the naked short-selling issue has attracted a lot of momentum since it appeals to a deep-seated human emotion: the unwillingness to admit that one has been conned. People who have bought the stock of a company run by promoters or con men would prefer not to admit that they were the victims of their own foolish greed. Rather, it is far more palatable to follow the suggestions of these very same con men that they, the buyers, were the victims of a dark, mysterious, wide-ranging, short-selling conspiracy. Not surprisingly, this deep well of discontent is also appealing to politicians who see it as a source of potential votes. What is surprising, though, is how little the Commission has done to dispel the myth.

Ironically I side with many of the other commentators on Reg SHO—those on the other side of the issue. I believe that greater transparency would be in everyone's interest. However, I believe that what they are requesting is SELECTIVE transparency. They are requesting greater transparency from brokerage houses and the DTCC. What I am suggesting is that the transparency should extend to the stock issuing companies themselves. Why has the SEC conveniently let the management of non-filing companies get away with not filing Form 4's—even though the non-filing status does not relieve insiders of that responsibility? Why are the dilutive terms of a financing never apparent until much later in a 10-K, if at all? Why are the penalties for covertly diluting a stock so seldom enforced in the real world?

However, even though greater transparency is a worthwhile goal, there is another equally worthwhile goal—trying to conserve taxpayer and consumer dollars. Layers upon layers of regulation, which serve no real purpose, are not in our best interest. So my suggestion is to heed the cries of the critics and take a handful of companies—why not take a couple that the critics are most concerned about?—and have total transparency on those. Let independent auditors check each trade to make sure there is no naked short-selling. But also have them check the brokerage statements of the company insiders, promoters, and relatives. My hunch is that this would be a very revealing exercise—though not in the way that the critics expect.