To all interested parties,

Far too much credit is being given to the SEC as it pertains to the past release of and recent changes to Regulation SHO. The SEC, and specifically the Division of Market Regulation, has confused the people on the mandates handed down by Congress under Section 17A of the Securities Act of 1934.

Under Section 17A of the Exchange Act the Commission is mandated to:

a. **Congressional findings; facilitating establishment of system**

   1. The Congress finds that--

      A. The prompt and accurate clearance and settlement of securities transactions, including the transfer of record ownership and the safeguarding of securities and funds related thereto, are necessary for the protection of investors and persons facilitating transactions by and acting on behalf of investors.

      B. Inefficient procedures for clearance and settlement impose unnecessary costs on investors and persons facilitating transactions by and acting on behalf of investors.

      C. New data processing and communications techniques create the opportunity for more efficient, effective, and safe procedures for clearance and settlement.

      D. The linking of all clearance and settlement facilities and the development of uniform standards and procedures for clearance and settlement will reduce unnecessary costs and increase the protection of investors and persons facilitating transactions by and acting on behalf of investors.

   2.

      A. The Commission is directed, therefore, having due regard for the public interest, the protection of investors, the safeguarding of securities and funds, and maintenance of fair competition among brokers and dealers, clearing agencies, and transfer agents, to use its authority under this title--

         i. to facilitate the establishment of a national system for the prompt and accurate clearance and settlement of transactions in securities (other than exempt securities); and

         ii. to facilitate the establishment of linked or coordinated facilities for clearance and settlement of transactions in securities, securities options, contracts of sale for future delivery and options thereon, and commodity options;

      in accordance with the findings and to carry out the objectives set forth in paragraph (1) of this subsection.

This mandate from Congress does not provide a differentiation between a threshold security and a non-threshold security but pertains directly to all trades regardless of abuse levels. The SEC chose a different path to take.

"The need for prompt and accurate clearance and settlement of securities transactions are necessary for the protection of investors and persons facilitating transactions by and acting on behalf of investors."

Congress never intended to minimize the need for investor and market protection to levels where the abuses can be at their greatest risk. Simply put, the delays in issuers becoming a threshold security allow for a significant level of abuse to take place well above the threshold levels defined. The SEC only now being addressed this mistake by the rescinding of the grandfather clause they understood to become an umbrella of regulatory free abuse.

Q: Of the companies that become listed on the threshold security list with the grandfather clause in place, what was the level of fails that was accumulated between the time the issuer first broke the 0.5% threshold and the level when the stock was first listed [5 days later]?

This proposal is requesting comments on when and how an options market maker should be given an exemption to settling trades.

Present SHO proposals allow such settlement failures to persist for the length of an options contract, which can be extended out for years. Many large companies have options contracts dating into 2010 and beyond and thus, how does the SEC rationalize violating the requirements of Section 17A and the prompt and accurate settlement of trades while creating rules that would allow for fails to deliver to exceed multiple years in hard to borrow securities?

Q: At what point does the investor who purchased such shares have the right to the delivery of such shares and is it not imperative that the settlement process be enforced to protect the integrity of the marketplace today?

No market maker exemption [equity or options] should ever exceed 30 days regardless of whether the failed trade was on a Regulation SHO threshold security list or not. Trades executed under such exemptions should be forced to be closed within 30 days and closed with the purchase of a share that will be guaranteed delivery and not through the purchase of a share that results in a secondary fail and a restart of the clock.

There are far too many unscrupulous market makers out there working together in collusion to roll failed trades amongst each other to prevent companies from appearing on SHO or to roll the date on the origination of failed trades.

To date the SEC has failed to really address the issue of settlement failures in the marketplace. The fixation by the SEC with "threshold levels" has created an illusion that a problem was being solved while leaving gaping loopholes for abuses to occur in smaller more controlled fashions. The law does not differentiate a threshold failure from a non-threshold failure and yet the SEC has.

For those that believe that the elimination of the grandfather clause will end all abuse guess again. This elimination only comes into play with settlement failures associated with the trading that generally takes place in the 5 days prior to a company being listed on Regulation SHO's threshold security listing. The real fix is for a more thorough analysis on why failures exist in the first place and address that regardless of threshold levels.

With regards to this proposal the SEC is asking us to think about the options market maker exemptions, should they exist and if so by how much?

Had the SEC been proactive they would have looked deeper into who was creating such failures at these absurd levels and evaluated patterns of individuals who were ultimately responsible as a reasonable approach to looking into a reform. The market makers say they require such exemptions to be providing a service but ultimately what service is being provided – market manipulation?

Market makers have become an unnecessary tool in these markets when investors themselves have the opportunity to not only buy but also write options contracts. As such the supply and demand for such contracts should be based on the interests of investors and not based on the market makers ability to draft risk free contracts with unlimited levels of exemptions. When a market maker carries such dominance in fails to deliver relative to a public float for an issuer it stands to reason that the fails are being created for the strategic interests of a select few.

For example: Overstock.com accumulated a failure level of over 3.5 million shares while under SHO. When they reached SHO the levels were approximately 250K shares implying that nearly 3.25 Million failures were associated with options contracts exempted from settlement. Such levels represented 40% of the entire public float and were the cause for so many equity buy-in failures.

Q. Should Options market makers be allowed to carry such an impact on the marketplace simply to be provided the ability to exist free of risk?

The SEC has a responsibility to this country and to the people who invest through our financial system. The SEC has the limited authority of only presenting civil enforcement actions and thus should set up the clear guidelines of law that simplify the differentiation between a civil and criminal act of fraud. Markets today are being manipulated and money is being stolen no differently than when a bank robber robs a bank yet the laws are so open to interpretation Wall Streets robbers are slapped with civil infraction parking tickets instead of a jail sentence.

Today the SEC has the opportunity to focus directly on the laws as mandated by Congress – Prompt and Accurate Settlement of Trades. I suggest the SEC carefully research why such trades continue to persist beyond reasonable levels and create laws that would deter such future violations that manipulate our markets and destroy the integrity and confidence you are chartered to protect.

The SEC must institute rules that make it easier to convict under federal criminal laws so that the risk vs. reward of a civil compliance is no longer a consideration when fraud is being committed. Eliminating market maker exemptions – equity and options – or placing a much tighter restriction on how and why they are being used is closing one loophole every regulator knows is being abused.

The future of our markets is in the hands of the SEC Commission staff today. So far the window dressing created by SHO has proven insufficient in stopping the abuses and have only provided small opportunities to capture the fraud and abuses well after the damages are done and after the underlying equity market cap had been manipulated down. The fines when caught paled to the market cap losses to the investing public.

Today computers capture every level of a fail including the date in which it was created. All fails, regardless of age or cause should be forced closed after 30 days of existence. Exemptions should be addressed on a case-by-case basis making it more difficult for firms to accept them as simply status quo.

Dave Patch
www.investigatethesec.com