

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

**Re: Comments on Proposed Amendments to Regulation SHO**

**File No S7-19-07**

**Dear Secretary Morris:**

I thank you once again for yet another opportunity to comment on the proposed amendments to Reg SHO. One suggestion that I have noticed that seems to be gaining traction in addressing naked short selling and delivery failure related abuses amongst securities scholars has to do with incorporating the “Net Capital Rule” or Rule 15c3-1 of the ’34 Exchange Act as a deterrent for delivery failure related abuses. A brief summary of the Net Capital Rule is as follows:

**NET CAPITAL RULE** – An SEC regulation that requires **broker-dealers** to maintain “net capital” (net worth adjusted by certain deductions for illiquid assets and reserves against possible market losses on **securities** positions) such that the liabilities incurred by the broker-dealer (its “aggregate indebtedness”) does not exceed a certain percentage of the broker-dealer’s net capital or of a specified percentage of the aggregate of transactional moneys owed to the broker-dealer by customers (its “aggregate debit items”). Broker-dealers are required to suspend or terminate their securities activities if they are unable to meet this test.

Since the majority of the crimes perpetrated in this particular variety of securities fraud involves the illegal accessing of the “Bona fide” market maker exemption from borrowing or making “Locates” before short sales are executed then your focus of attention should obviously be upon establishing policies to act as a deterrent to these activities. If these deterrent measures also provide a mitigation of systemic risk then that’s all the better.

What you might concentrate on is the reason for this incredibly powerful but universally abused exemption. The premise of this exemption is that in the markets of thinly-traded securities a truly “Bona fide” market maker needs to be able to react quickly to order imbalances wherein the level of buy orders and sell orders present at a given time are disproportionate in size. This allows a truly “Bona fide” MM to sell nonexistent shares into buy orders that dwarf sell orders. The idea is to buffer wide but unsustainable swings in share prices.

When “Not so bona fide” MMs acting in concert with unregulated hedge funds run up astronomically large naked short positions while abusing this exemption you at the SEC must realize that the covering of these naked short positions in these thinly traded securities is going to drive the share price up much more dramatically than in the markets

of securities that are not thinly-traded. This fact needs to be incorporated into the calculations of “Net Capital” to mitigate especially “Systemic risk” issues. It would also create a much needed deterrent to these predatory activities. The concept is simple. If thinly traded securities need special treatment in regards to borrowing before making short sales then they also deserve special treatment in the calculation of “Net capital” reserves. I thank you for considering this approach.

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