May 29, 2008

Securities and Exchange Commission
100 F Street NE
Washington, DC

Re: Release No. 34-57511; File Number S7-08-08
Proposed Rule 10b-21

Mr. Chairman, Commission Staff,

By now it can be no secret that my position regarding this issue differs greatly from that of the industry members and primary industry players. My position represents that of the smaller investor for whom the members solicit business but investors who rarely carry a voice when it comes to regulatory protection. To that pedigree of investor I would say I represent it has become clear to us all that the interests of protecting us have come in conflict with the rights and needs of the industry to grow and prosper. Such conflicts have many times left us, the majority in numbers, naked to the world of abuse.

As has also been no secret, I have likewise questioned the Commission policies and procedures regarding the process utilized in the making of sound reform decisions. Clearly there has been a bias to provide the industry members access to the decision making staff in order to discuss more openly and deeper the rationalizations to their thought process and to their concerns. Cost is never far from their list of concerns as it is typically a major topic of discussion as evidenced by the Commissions acknowledgement that such meetings have taken place.

Many times left untouched as a topic of conversation is the cost of not taking appropriate action. The cost of investor confidence, the cost of losing business development and growth, and the cost of lost technology and jobs.

For your part, the Commission has denied entirely the same access to the general public despite a clear sign that the public has an opinion and it grows exponentially over time. The less affluent are not provided equal time to discuss their costs and needs and the results are again becoming clear.

I believe that the most recent comments presented by the industry may best explain the reason for the industry option for a private meeting over making public responses. The industry members do not represent the interests of the majority public and would prefer not to make such commentary public for fear of what such biased thinking would do to their credibility.

Consider for a moment the comments from Ira D. Hammerman, Managing Director and General Counsel of Wall Street's primary lobbyist the Securities Industry and Financial Markets Association (SIFMA) and those of former Congressman Richard H. Baker and now President and Chief Executive Officer of a Hedge Fund Lobby group, Managed Funds Association (MFA).

After reading the comments one after another and doing so several times over it is clear to me that while these two lobby firms come to similar conclusions they likewise come to similar levels of denial in responsibility towards the abuse that exists today. Part of that is entirely the fault of the Commission and the way the Commission has misrepresented the efficiency of Regulation SHO.

Ira Hammerman; "As repeatedly noted by the Commission, overall Reg SHO appears to be having its intended effects without imposing undue impacts on the market, as evidenced by a steadily declining level of fails-to-deliver, as well as a declining number of Threshold Securities."[1]

The Commission, and we hope Mr. Hammerman, can not believe this statement to be an accurate assessment of Regulation SHO. Yes it is a fact that the Commission has repeatedly touted the success but with the dollar value of fails in 4Q2007 exceeding the dollar value of fails in 1Q2005 by a factor of 2 to 1 one would be hard pressed to call this a success.

Not to be outdone Richard Baker remarked: "Indeed, manipulative purchases—for example, so-called pump-and-dump schemes, appear to be far more common than abusive short sales. Historically, there have been far more market manipulation enforcement cases against pump-and-dump boiler room operations than short sellers. Thus, we question the need to single out naked short selling from other transaction types." [2]

Mr. Baker would have the public and the Commission believes that enforcement actions are directly correlated to abuse. Without enforcement action there can be a denial that any abuse even exists. I believe that this misconception is based on the agencies public denial that naked shorting has ever really been a problem over these past years despite evidence that says otherwise. In fact, many believe that the origination of the allowances for naked shorting manifested with the Commissions desires to offset a problematic period of significant 'pump and dump' schemes through the access to the short sale and more importantly the illegal naked short sale.

The rationale, the short sellers would maintain pricing controls in a pump and dump situation thus protecting investors. The problem has been that over time the settlement failures expanded beyond those potential pumps and dump entities and expanded into real companies with real businesses and real investors putting up their savings. The rogue short seller has morphed into a bigger and more powerful beast that now champions a former US Congressman to lobby for their continued rights.

Ultimately it is the responsibility of the Commission to correct these misconceptions created by the Commission staff and yet the Commission fails to take upon itself to do so.

Settlement Failures; Clients are to Blame:

If you believe the interests of SIFMA, representing the member firms and broker-dealers, Rule 10b-21 is overly restrictive to member's interests in trade execution and overly burdens them to manage their client's activities.

"SIFMA strongly encourages the SEC to continue to allow executing brokers to be able to reasonably rely on such customer representations, as prohibiting such reasonable reliance would adversely affect and needlessly delay the executions of clients' legitimate orders."

To address such an issue SIFMA has recommended that the SEC alter the language of the proposed 10b-21 to focus entirely on the Seller. *"As such, SIFMA urges that Rule 10b-21's focus remain on the "seller," and that a broker-dealer not be held to unreasonable standards with respect to monitoring its CNS fail-to-deliver position for purposes of determining potential violations of Rule 10b-21 by sellers."*

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1 Comment Letter Ira Hammerman to SEC http://www.sec.gov/comments/s7-08-08/s70808-467.pdf
2 Comment Letter Richard Baker to SEC http://www.sec.gov/comments/s7-08-08/s70808-465.pdf

What Mr. Hammerman fails to disclose in his argument is that the seller is on many occasions a non-registered entity and without the responsibility of maintaining fully audited compliance systems. Mr. Hammerman also fails to disclose that in many cases the broker-dealer executing these trades has suspicion that these trades may fail but executes them anyway in order to book the trade commission and the future trade commissions this client will bring to the table. SIFMA would prefer that the Commission allow broker-dealers to ignore their suspicions despite the markets self-regulation format and execute the illegal trades without liability none-the-less.

Rule 10b-21 does not imply that every failed trade would be a violation but it does imply that repeated trading under similar failure by similar parties would no longer be accepted as simple compliance oversight. How SIFMA can argue with this line of reasoning is disturbing to say the least.

Ultimately, somebody, as a registered entity of the industry must be held accountable for compliance. When a client is not a registered member of the Commission accountability must default automatically to the registered member in the trade equation. It would not be any dissimilar to affirmative determination rules drafted where member firms are responsible for assuring AD when a trade is entered by a non-registered member.

Observations by the FINRA during their more recent audits of broker-dealers have revealed that *"We see executions on short sales where a locate amount is lower than the amount of the size of the short sale order. So a broker has accepted and going on and executed a 10,000 share short sale where the customer had given instructions and given location but they had obtained the locate for 5,000 shares. We've seen customers executing short sales without locates or sometimes citing Easy-To-Borrow lists erroneously. Some firms have systems built in where a short sale, especially, systemic executions where the short sale is linked directly to an Easy-To-Borrow list.*

And so, if that list is inaccurate or erroneous the customers are relying on a record that's not accurate at all, they should not have relied on that locate. We have found instances where securities are on an Easy-To-Borrow list and the firm actually had significant fails in that position. Now that would make sense if that's a security that should not be on an Easy-To-Borrow list. Those are generally some of the types of findings we've found in regards to customer locates, and in particular, locates done away from the executing broker."[3]

This statement was made by Anand K. Ramtahal, VP, FINRA during a May 5 Operations Conference before the members and representatives of SIFMA. Mr. Hammerman would like the Commission to believe that these failures at the broker-dealer level, repeated failures, should not be evaluated as a 10b-21 violation. That trade efficiency is more important than trade settlement policy.

Clearly Regulation SHO has not altered the policies of these member firms so a tougher more accountable stance is necessary despite the cries from Wall Street.

Settlement Failures: Systems are to Blame

Baker: "The fear that operational failures could potentially subject sellers to antifraud allegations would have a negative impact on short selling."

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[3] SIFMA Operation Conference Transcripts – REG SHO Workshop http://investigatethesec.com/drupal-5.5/node/301

There is $7 Billion or more in aggregate failed trades every single day. This isn't a guess, it is direct data taken from the fails data now published by the Commission. Some of these fails are exempted under the market making rules but all others, bar none, must meet the trade obligations of Rules 15c3-3 and 15c6-1. There are no "operational failures" that would satisfy a trade failure exceeding 10 or even 5 business days but they do today.

The hedge funds represented by former Congressman Richard Baker are wealthy funds that choose not to be registered with the Commission. These funds do not want their "Operations" audited because of the expense of such compliance systems. How then can Mr. Baker argue that his clients have legitimate operational failures when such operations are not under the guidance of third party surveillance?

"Similarly, if stricter security lending standards and recordkeeping requirements are implemented, we are concerned that trade execution quality will suffer to the detriment of investment management clients."

I believe this comment is highly self serving, Hedge Funds do not want to maintain proper records or set up proper compliance systems because the "trade execution quality", which is code for cost of doing business, would increase and cut into a managers profits. How the lack of compliance control impacts the quality of the market itself is not of interest to this lobbyist and the funds he represents.

Threshold or No Threshold

If you read between the lines of Hammerman, SIFMA would like the Commission to distinguish between levels of deceit depending on circumstance. Somehow SIFMA has worked themselves around the issue of the Securities Act of 1934 which requires the prompt and accurate settlement of all trades and Rules 15c3-3 and 15c6-1 promulgated thereafter by wishing to limit 10b-21 to threshold securities.

Has the requirement for trade settlement suddenly been narrowed? Do the member firms not have an obligation to close-out all failed trades in a prompt and orderly fashion regardless of the status of the failure pool in that issue?

To narrowly focus on threshold securities allows the members, and those clients who presently collude with member firms, to manipulate a market through the use of a limited threshold list. Such manipulation could easily take place in the timeframe allotted before a company is identified as a threshold security as has been evidenced by the recent trading data. Large levels of settlement failures can accrue quickly in a security that is not on the published threshold list. The intent of the failures would be to manipulate the market and drive investors out allowing for trades to be covered quickly and eliminating threshold status before threshold status is achieved [mini bear raid].

By the requests of SIFMA, deception in the execution of these trades would not be covered under 10b-21. I would be more inclined to ask – why not?

Conclusion

There is no rational reason for this to be as hard as the industry and the members make it out to be. The laws are clear; three-day settlement is the intent of Congress and the intent of Security Law. With the evolution of electronic trading and electronic record keeping in place today three-day settlement should not be hard to achieve.

So how are continued allowances for operational glitches to be handled and differentiated between the casual error and the planned excuse?

There will be no dispute that operational problems exist and will continue to exist. Likewise there is no dispute that under the present locate and borrow system a locate could be provided to one or more investors at the same time causing the potential that one or more may fail settlement. It is not the failure itself that is the issue; it is the lack of action thereafter by the broker-dealers that brings risk of fraudulent intent by either the client or the represented broker-dealer.

Short Sellers must understand that in the execution of a trade that trade could be bought back in should the trade fail settlement. It is a risk to the trade and a decision made in not pre-borrowing a share located. We know that hedge funds locate and desk shares to take them out of circulation for others to use or to use for voting purposes. These same funds can protect their investment by executing a pre-borrow if there is a risk of trade failure. This is risk mitigation.

When an investor purchases long and fails to provide the capital to purchase the shares purchased are sold immediately after the failed payment in order to pay off the debt. If necessary additional shares in the portfolio will also be sold until the debt is paid in full. The short sale should be treated no differently.

When a short sale is executed and a client or broker-dealer fail to deliver within a reasonable and limited time the short sale should be closed out with ***guaranteed delivery of shares*** through a trade in the open market. Not the present “best effort” we hear of today where the excuse has been that no shares were available in the market to purchase. If there is trading there damn well better be legitimate shares available. If not the Commission should be investigating and understanding why not.

If there is a profit or loss in a buy-in executed such would go to either the broker-dealer or the short seller based upon the terms of the trade. Never should the fail simply linger on indefinitely because a borrow could not happen or because an “operational mistake” took place.

The fact that SIFMA and the MFA are both opposed to enforcing the rules of trade settlement is ultimately what is wrong with the markets today. The biggest players in the game are constantly looking for an edge by looking for ways to game the system and the rules that come with it. Unfortunately to date the Commission has allowed such to happen and happen at an alarming frequency.

Before the Commission can take seriously the comments of SIFMA and the MFA the Commission should provide clear rationalization to the general public, the 90+ Million average investors out there who put their trust and faith in the SEC’s regulatory system, why such accommodations to fail trades would be made to the wealthiest of market participants.

Rule 10b-21 has been identified as a rule that simply mimics that of pre-existing 10b-5 guidelines and thus was thought to be unnecessary. Clearly something in this duplicative rule upsets the ‘players’ out there or they would not be fighting so hard to convince the Commission it is not necessary.

It is my opinion the Industry’s concern stem from the fact that the Commission is now being clear that the deceit that has been taken for granted for so long will no longer be accepted at preset face value. The gig is up, the abuse exposed, and now it is time to clean it up. There is a reason Regulation SHO has been a failure and that reason is the very deception being looked at here. The wink and the nod between member firms and wealthy clients, the wink and nod that has been excused as ‘operational errors’ for years is now under fire and a work around plan has not yet been created by the crooks and criminals in play.

The Commission gave SIFMA their opportunity back in 2004 when the Commission backed down on a stronger reform package when SHO was released. SIFMA commanded a need for the grandfather clause and promised to slowly clean up this mess. SIFMA and the members they represent lied. Nothing changed and the problem got worse.

SIFMA is again asking for a grandfather clause by asking the commission to excuse member fraud leading up to threshold security status. SIFMA is seeking leniency in responsibility to manage their clients despite the fact that this is a self-regulatory system where their clients are not under SEC registration. And SIFMA and the MFA are asking for leniency in the responsibility to close out trades executed legally or illegally when a failure results despite the fact that all pre-existing laws demand prompt settlement of trades.

It is called a guaranteed buy-in Mr. Chairman and every broker-dealer in the nation has the power to execute one. The guaranteed buy-in is the accountability that holds every player in this trade honest. To date nobody wants to execute one because it has financial implications to the client and the firm that makes millions off that clients trading volume. Ignoring this responsibility is fraud and every member and client should understand that simple fact.

My personal opinion is, any client or firm that does not have the sole intent of settling within 3-days has violated rule 15c3-3 and should be called to the carpet on it. If a settlement failure is promptly closed out there would be no worries as the mistake was promptly corrected. If a settlement failure persists it is because the executing broker and/or the client really had no intention to settle on time and a fraud violation should be seriously considered. In the past the SEC has provided documents outlining settlement failures persisting for over one calendar year. No enforcement action as taken despite a clear intent to commit fraud.

The Commission is in charge here, it is time they acted as such and stopped allowing politically connected hedge funds and wealthy members dictate how fraud will be handled.

Dave Patch
www.investigatethesec.com

What ever happened to the Philosophy of Honoring Trade Settlement?