Re: S7-08-08
The proposed Rule 10b-21 Amendment to the '34 Exchange act

Dear Chairman Cox and Commissioners,

I thank you once again for the opportunity to comment on the proposed Rule 10b-21 addressing abusive naked short selling (ANSS) frauds. A rare opportunity to get inside the heads of the secretive Wall Street brokerage industry and secrecy-obsessed hedge fund community occurs when the SEC invites "comment letters" on proposed legislation attempting to address corrupt practices on Wall Street. If not contested by those in favor of and benefiting from the corrupt "status quo" on Wall Street the end result might be changes to this "status quo" lest these parties not allow their powerful voices to be heard. The problem for these market "professionals" is that they must go public with these "comment letters" wherein the victims of these corrupt practices get a glimpse of the mindset and perhaps the identity of those fighting to maintain the corrupt status quo. What further complicates matters for those in favor of the corrupt status quo in the case of abusive naked short selling (ANSS) is that this subject matter has gained the attention of victimized investors worldwide that are angrily screaming for <u>meaningful</u> reform.

Those in favor of the corrupt status quo then have the unenviable task of convincing the SEC in a public forum that the corrupt status quo is just fine while not revealing to the victims of these abuses any information that might serve to individually identify these parties and make them the target of any investor efforts to seek compensation for damages incurred. In other words from doing the targeting of corporations to bring down to becoming the target of perhaps criminal investigations. After all, the victims of these abuses are the brokerage firms' clients and Rule 10b-21 brings into the mix concepts such as "deception" and "fraud" and the "aiding and abetting" of criminal behavior. Thus it becomes necessary to utilize a "lobbyist" or "trade group" of b/ds or hedge funds to attempt to get their points across such that the individual b/ds and hedge funds proffering these arguments cannot be identified and directly linked to the often unpopular stances being taken. Usually just the opposite is true when the angry individual victims of these crimes submit "comment letters" that they typically sign off on individually. In this particular "comment letter" solicitation process associated with 10b-21 it does not appear that any one brokerage firm cared to individually proffer <u>any</u> of the perhaps 20 or so arguments against the SEC's proposed Rule 10b-21 that their lobbying group SIFMA decided to posit. As you read the "comment letter" perhaps you'll understand why.

All of this results in the necessity to proffer some pretty interesting arguments in defense of the currently corrupt status quo. One trick of the trade I've noticed is for the "lobbyists/trade groups" making the arguments in favor of the status quo to send in their "comment letters" <u>after</u> the deadline date for submission (release date plus 60 days) has expired perhaps so that the SEC sees it but less investors see it and the chance for rebuttal is minimized. True to form <u>both</u> groups of lobbyists representing the hedge funds (MFA) and the broker/dealers (SIFMA) sent in their comment letters pushing for the maintenance of the status quo two to three days <u>after</u> the expiration date for comments. This followed approximately 400 or so comment letters perhaps 98% of which <u>angrily</u> demanded a radical change from the status quo.

Below I've copied both of these trade groups' "comment letters" in regards to the proposed Rule 10b-21's changes suggested by the SEC to address naked short selling frauds that remain pandemic in nature even after Reg SHO became effective on 1/3/05. The gist of the proposed Rule 10b-21 is incredibly simple and nearly impossible for any neutral party to find an issue with. The proposed rule simply deems it unlawful or fraudulent for sellers of securities (including b/ds trading for their own accounts) to **"deceive"** market intermediaries and purchasers of shares in regards to their ability or intent to deliver shares by settlement date or to **"deceive"** these parties in regards to the "ownership" of that which they are selling as well as the "locate" sources utilized in the short sale transaction. I've inserted my comments parenthetically and written in red to a select sample of the arguments being made.

These opportunities to get inside the heads of the secrecy-obsessed hedge funds and Wall Street community come few and far between but they do provide excellent educational opportunities and due to the heinous and obvious nature of refusing to deliver to the purchaser that which you sold them i.e. "abusive naked short selling" (ANSS) frauds and delivery failure related abuses (DFRAs), the elimination of these frauds centers around the **education** of everybody from the investors being robbed all the way up to the Congressional Oversight Committees responsible for overseeing the SEC as well as the DOJ.

From an educational point of view I've found it easiest to summarize the proposed Rule 10b-21 as follows:

It shall be deemed unlawful/fraudulent for short sellers to use **deception** associated with:

1) Their intent on delivering the shares sold short by settlement date.
2) Their ability to deliver shares sold short by settlement date.
3) Their sourcing of Reg SHO mandated "locates" or "pre-borrows".
4) Their "ownership" of the shares being sold (as it typically relates to intentionally lieing about "ownership" and labeling "short sales" as "long sales" usually in an effort to illegally circumvent expensive or unavailable "locates" or "borrows".)

As you can see below their arguments are eloquently presented and they are well-organized, well-educated and well-funded. The investors seeking relief from market abuses, however, are not well-organized, not well-educated in naked short selling matters, not well-funded and do not have equal access to the ear of the regulators and SROs.

THE SIFMA LETTER (**S**ecurities **I**ndustry and **F**inancial **M**arkets **A**ssociation)

May 22, 2008
Ms. Nancy M. Morris
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-9303
Re: Release No. 34-57511; File Number S7-08-08
Proposed Rule 10b-21
Dear Ms. Morris:

The Securities Industry and Financial Markets Association ("SIFMA")[1] appreciates the opportunity to comment on the Securities and Exchange Commission's (the "SEC" or "Commission") proposed anti-fraud rule, Rule 10b-21 (the "Rule") [2], which is intended to target: (i) short sellers who deceive certain persons, such as their broker-dealers, about the source of borrowable shares, in order to circumvent the Regulation SHO "locate" requirement; and (ii) long sellers who misrepresent to their broker-dealers that they own the shares being sold. (Comment: Actually these are "short sellers" that intentionally mislabel "short sales" as "long sales" in order to circumvent the expense or unavailability of borrows or locates especially as they pertain to the "hard to borrow" securities of the corporations typically attacked in this crime wave. Their goal is to get the resultant FTD (failure to deliver) hidden in either an ex-clearing format or at the DTCC in their "C" sub accounts where DTCC management can be 100% counted on to hide the FTD from public view and to plead to be "powerless" to buy-in the delivery failure no matter its age despite the fact that they have been delegated the SEC's congressional mandate to "promptly settle" all transactions.) Specifically, Proposed Rule 10b-21 would be violated if: (1) a seller of a security deceives a broker-dealer, participant of a registered clearing agency, or purchaser (emphasis added) (Comment: How refreshing for the congressionally mandated provider of "investor protection and market integrity" (the SEC) to finally recognize the **"purchaser"** of these bogus shares being sold i.e. the "victims" of these thefts. Note that all of the unfortunately unidentifiable "purchasers" of naked short sold shares as well as **all** current shareholders of the corporations involved are deceived and damaged by "naked short selling" unless the naked short sold shares were sold by a truly bona fide MM while acting in that capacity. This is due to the fact that the DTCC chooses to hold all shares in "street name" in an "anonymously pooled" or "fungible mass" format. Although this policy streamlines the clearance and settlement system it unfortunately precludes an investor from being able to track the whereabouts of the specific parcel of shares that he or she purchased and whether or not it was ever delivered on settlement date.

A "theoretically" bona fide MM that illegally accesses the exemption from performing "locates" and "pre-borrows" before making admittedly naked short sales i.e. he labeled the short sale "SSE" or "Short sale exempt" and that absolutely refuses to cover his pre-established naked short position as the PPS drops would obviously also be guilty of deception/fraud and causing damages as a truly bona fide MM with an outstanding naked short position in an issuer would, **by definition,** cover this "open position" as the share price of the issuer drops and buy-side liquidity is in need of being injected. Note that even if the MM didn't have a preexisting naked short position established after declaring himself as a market maker in a security he is obligated to stand ready to inject liquidity on the buy-side as the PPS drops. It is, however, totally inexcusable and fraudulent not to cover previously established naked short positions as the PPS drops. Part of the problem is associated with the lack of a "barrier to entry" to becoming a market maker. You merely need to file or piggy-back onto another b/d's 15c-2-11 and voila you're a MM capable of accessing that incredibly powerful exemption for your own predatory trading intent or for that of those with deep pockets willing to steer you order flow in exchange for your willingness to illegally access that exemption. If aiding and abetting liability were a reality then abusive MMs might think twice about prostituting themselves in search of the almighty dollar.) regarding its intention or ability to deliver the security sold on the date delivery is due; (2) the seller fails to deliver the security sold and (3) the seller acts with scienter. (Comment: Thus in the proposed Rule 10b-21 you need all 3 of the following prerequisites to be held liable for unlawful or fraudulent activity: deception, an FTD (failure to deliver) and scienter i.e. a mental state embracing the intent to deceive, manipulate or defraud. Note that in actuality this would appear to be extremely forgiving for those involved in inadvertent delivery failures not of their own fault which is indeed appropriate. You'll see in a moment wherein the authors of this "comment letter" will attempt to obfuscate the issue and argue that one of the "unintended consequences" of this ill-conceived rule is that those making inadvertent delivery failures will get "busted" right and left.

With an FTD listed as being one of the three prerequisites one can appreciate how critical it is for the SROs and regulators truly interested in addressing this crime wave to monitor for and tally **all** FTDs wherever they occur. This especially includes those created and held in an "ex-clearing" format which has become the location of choice for perpetrating these frauds since Reg SHO only pertains to abuses occurring in a "registered clearing agency" (RCA) like the DTCC. Since the parties being damaged i.e. the deceived purchaser of the shares involving ANSS as well as all other shareholders of the corporation under attack have no clue that any of the three prerequisites have occurred then the burden would obviously fall on the SROs, the regulators or perhaps the DOJ to detect these unlawful or fraudulent behaviors by firstly recognizing and tallying all FTDs. Even the "agents" of these purchasers being defrauded, the purchasing b/ds receiving a commission and therefore owing a fiduciary duty of care to the purchaser, are blindfolded to these frauds due to how our current clearance and settlement system utilizes a "netting" procedure known as CNS "netting'. You'll notice the recurring theme in these ANSS frauds being the lack of transparency needed as a prerequisite for committing frauds as obvious as refusing to deliver that which you sell.

The obvious place to start in addressing these crimes is for these parties to have full visibility of all FTDs and then determine if the other two prerequisites have been met. This is going to necessitate the SEC taking a different attitude than turning a blind eye to the crimes being committed in the "ex-clearing" arena seen heretofore. The public disclosure of the absolute number of FTDs poisoning the share structure of a given U.S. corporation is mandated by the '33 Act-"the Disclosure Act" since this information is irrefutably of a "material" nature. In fact no information could possibly be more "material" to a prospective investor in especially thinly-traded development stage corporations particularly susceptible to these frauds. If the corporation under attack has so many preexisting FTDs poisoning its share structure that it has been effectively preordained to die an early death then that would be a "material" fact that must be made public to any prospective investor. If that policy might prove to be too embarrassing to the authorities then perhaps the excessive levels of FTDs currently damaging issuers and their shareholders should be proactively removed so that the truth can be told and so that our regulators won't be guilty of breaking the very tenets of the 7 securities acts they are commissioned to enforce.)

I. Introduction and Executive Summary

SIFMA strongly supports the SEC's stated goals of addressing potentially abusive "naked short selling" practices. Though not defined, (Comment: This lack of a formal legal definition for "abusive naked short selling" (ANSS) is itself an absurd concept that needs to be addressed before any meaningful reform can be accomplished. After all how can a regulatory authority deal with a crime that has no formal legal definition? Might I suggest: "ABUSIVE NAKED SHORT SALE" (ANSS)-the fraudulent sale of a security that involves a delivery failure, scienter and deception in regards to either the ability or the intent of the seller to deliver shares sold by settlement date, deception involved in the sourcing of the mandated "locate" or "pre-borrow" as per Reg SHO or deception involved in the "ownership" of the securities being sold as defined by Rule 200 (b) of Reg SHO. (Note that the illegal accessing of the exemption from mandated "locates" and "pre-borrows" by market makers not acting in the capacity of a truly bona fide MM willing to inject both buy-side and sell-side liquidity when order imbalances occur would obviously qualify as a form of "Abusive Naked Short Selling" or "ANSS". It is critical for Rule 10b-21 to specifically address this point as the majority of ANSS frauds are currently being committed by "not so bona fide" market makers illegally accessing this incredibly powerful exemption to further their own "predatory" trading strategies or on behalf of others willing to direct them lucrative order flow or prime brokerage activity.)

With the above definition an "Abusive naked short sale" (ANSS) could then be equated to a "Fraudulent naked short sale" (FNSS) which could be contrasted with a "Legitimate Naked short Sale" (LNSS) performed by a truly bona fide MM while acting in that capacity. You remember these guys; they're the ones that will **both** sell when there is a preponderance of buy orders and buy when there is a preponderance of sell orders. A formal legal definition is direly needed and Rule 10b-21 seems to be a fitting location to introduce it.

Perhaps it was an oversight but the proposed formal text of 10b-21 in the release failed to mention deceitful locates and deceitful "ownership" allegations. It only mentioned the "intent" to deliver and "ability" to deliver issues. The more specific the text of the new law is the less is the need to use "Interpretive releases" which tend to dilute the deterrent effect of the law.)

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[1] The Securities Industry and Financial Markets Association brings together the shared interests of more than 650 securities firms, banks and asset managers. (Comment: Note that the "shared interests" of these securities firms are often not "shared" by their client investors due to the existence of massive amounts of "conflicts of interest" on Wall Street. This is despite the existence of a fiduciary relationship involving "agents" being paid commissions.) SIFMA's mission is to promote policies and practices that work to expand and perfect markets, foster the development of new products and services and create efficiencies for member firms, while preserving and enhancing the public's trust and confidence in the markets and the industry. (Comment: While reading through this "comment letter" please keep in mind the concept of "while preserving and enhancing the public's trust and confidence in the markets and the industry" and note the balance between this concept and the "shared interests of more than 650 securities firms, banks and asset managers" expressed within the suggestions made and note the lack of balance.) SIFMA works to represent its members' interests locally and globally. It has offices in New York, Washington D.C., and London and its associated firm, the Asia Securities Industry and Financial Markets Association, is based in Hong Kong.

[2] Securities Exchange Act Release No. 57511 (March 17, 2008), 72 FR 15376 (March 21, 2008) ("Proposing Release").

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naked short selling generally refers to instances where a short seller fails to confirm that there are reasonable grounds to believe the security sold can be delivered on settlement date, which may lead to the seller's broker/dealer not being able to deliver securities within the normal three business day settlement cycle (typically referred to as a "fail-to-deliver" or "fail"). While the Commission has recognized that naked short selling and/or failing-to-deliver shares is not necessarily manipulative or violative under all circumstances,[3] it has also noted that naked short selling can cause market operational problems, and may be used as a tool for manipulation. SIFMA firms strongly support attempts to address and prevent manipulative trading activity. SIFMA also applauds and supports the Commission's stated attempts to "aid broker-dealers in complying with the locate requirement of Regulation SHO"[4] and properly focus responsibility for potentially abusive activity on the party who is providing false information to the broker-dealer. (Comment: One must keep in mind, however, that the purchasing and selling b/ds involved in a securities transaction have a significant monetary interest in being "accidentally" deceived. This theoretical "deception" pays off very well for **both** the deceiver and those being deceived. The "deceiver" gets to bypass expensive and possibly unavailable borrows and the "deceived" selling b/d is directed order flow in exchange for playing the role of the "deceived" party. Abusive naked short selling hedge funds practicing this "deception" will go out of their way to seek out and direct lucrative prime brokerage business and order entry business to those SIFMA and DTCC members willing to knowingly be deceived especially if this abusive b/d is indemnified from being held liable for "accidentally" being deceived or aiding and abetting these thefts. It appears that the SEC is well aware of this as the proposed Rule 10b-21's release touches on "aiding and abetting" liability. Since nothing else seems to gain the attention of these fraudsters then perhaps this will appears to be the mindset of the SEC.)

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[3] "Naked short selling is not necessarily a violation of the federal securities laws or the Commission's rules. Indeed, in certain circumstances, naked short selling contributes to market liquidity. For example, broker-dealers that make a market in a security generally stand ready to buy and sell the security on a regular and continuous basis at a publicly quoted price, even when there are no other buyers or sellers. Thus, market makers **must** (emphasis added) sell a security to a buyer even when there are temporary shortages of that security available in the market. (Comment: Note the use of the words "market makers **must** sell a security". They **must** stand ready to address order imbalances in these fast moving markets even when there are no other buyers or sellers. The other side of this coin that abusive MMs don't like to comment on is that the "market maker **must** buy back these securities already sold" when the pendulum swings and an order imbalance involving sell orders dwarfing buy orders occurs. This is when the truly abusive MMs are nowhere to be found because selling securities even those that don't exist makes money in our incredibly corrupt current clearance and settlement system while buying back securities previously sold costs money. **The moment of truth occurs during the first downtick in share price after a naked short position has been established.** A truly bona fide MM will earn that incredibly powerful and constantly abused exemption he previously accessed and cover the previously established naked short position. The abusive MM will either not cover or even continue to naked short sell which drives the PPS downwards further which makes his previously established naked short position and capital reserves worth more. There is no securities rule or regulation that states that a MM **must** commit securities fraud by refusing to deliver that which he sold.

Oftentimes the reality is that an abusive MM after greedily establishing a gigantic naked short position **must** (by financial necessity) continue to sell fake shares just to keep the share price pinned down so that his collateralization requirements don't force him to dig deeply into his own cash reserves. This entire fraud is based upon the "Ultimate paradox" which involves the DTCC's unconscionable policy of allowing the sellers of nonexistent shares to access the money of investors even while absolutely refusing to deliver that which they previously sold. Instead the DTCC management only mandates that they "collateralize" this debt on a daily marked-to-market basis in which the collateralization requirements drop as the share price predictably drops from the accumulation of all of these readily sellable IOUs serving to poison the involved corporation's share structure.) This may occur, for example, if there is a sudden surge in buying interest in that security, or if few investors are selling the security at that time. Because it may take a market maker considerable time to purchase or arrange to borrow the security, a market maker engaged in bona fide market making, particularly in a fast-moving market, may need to sell the security short without having arranged to borrow shares." SEC, *Division of Market Regulation: Key Points About Regulation SHO* (April 11, 2005).

[4] Proposing Release, 72 FR at 15380.

[5] *See* Memorandum from the Commission's Office of Economic Analysis, dated August 21, 2006.

[6] Proposing Release, 72 FR at 15377.

The SEC has used its broad market authority to adopt rules and regulations governing naked short selling, chief among which is Regulation SHO ("Reg SHO"). As repeatedly noted by the Commission, overall Reg SHO appears to be having its intended effects (Comment: As SIFMA is well aware Chairman Cox has publicly stated that Reg SHO has not gone far enough in addressing these crimes which is why this rule was proposed in the first place. In the SEC open meeting approving the comment solicitation for Rule 10b-21 chairman Cox made it quite clear that Reg SHO lacked "teeth". Dr. Erik Sirri, the SEC's Director of the Division of Trading and Markets commented that the FTD problem is not getting any better.) 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 (Comment: Absolutely not true as many academics have pointed out through Freedom of Information Act (FOIA) analyses. On the contrary one victimized corporation just "celebrated" its 800th day on the Reg SHO "threshold list".)[5] Of equal importance, and due in large measure to the market disciplines imposed by Reg SHO, the overall number of fails-to-deliver is also extremely low, with data from the National Securities Clearing Corporation ("NSCC") showing that 99% (by dollar value) of all trades settle on time (Comment: Absolutely misleading as the CNS artificially "nets" out the delivery status of 96% of all trades. See the report (which SIFMA should be intimately familiar with) of former Undersecretary of Commerce Dr. Rob Shapiro pointing out the fallacy of these NSCC statistics that are misleading by as much as a factor of 25. The mere collateralization of "open positions" has nothing to do with making "good form" delivery resulting in "trades settling on time". On the contrary it serves to obfuscate the true number of FTDs and the fact that these trades are not legally "settling". The levels of FTDs are much, much higher than the 1% figure suggested by the NSCC which doesn't even address those held in an ex-clearing format, those "netted" or "collateralized" out of existence and those erased by the DTCC's "RECAP" system.)[6] This being the case, the SEC has continued to actively monitor and interpret Reg SHO, including taking recent action to address what it perceives to be persistent fails-to-deliver in a small handful of Threshold Securities, namely by eliminating the Reg SHO "Grandfather" provision (Comment: Which was railroaded through without public comment by the SIA which later became SIFMA i.e. the authors of this "comment letter". The public uproar over the SIFMA-sponsored "grandfather clause" was so deafening that the SEC was forced to rescind this "grandfathering in" of previous acts of blatant securities fraud. Recall that the SEC admitted that the "Grandfather clause" was needed to circumvent "upward price volatility" in shares of corporations "with large amounts of preexisting delivery failures". Translation: We don't want to induce a bunch of short squeezes because the FTD problems of some corporations has gotten so far out of hand that they are not currently manageable without causing market disruptions i.e. upward share price volatility resulting in "pricing efficiency" wherein unmanipulated supply and demand variables are allowed to interact to determine unmanipulated share prices.

True to form in their comment letter addressing the "proposed amendments" to Reg SHO which included the SEC's suggested rescinding of the "grandfathering in" of preexisting fails SIFMA once again fought bravely to keep the "grandfather clause" intact but the public uproar wouldn't allow it. They also fought bravely to keep the options market maker exception alive which is still yet to be addressed. SIFMA is also fighting the SEC's proposal to make those labeling sales as "long sales" to annotate the location of these shares that they theoretically "own". They argue that this "Long sale documentation requirement" is "impractical" and that it would "unnecessarily delay speed of execution of customer orders,

thereby exposing customers to market risk while their order is pending". Just how "burdensome" would it be to annotate the location of shares being sold on a sell ticket whether electronic or paper? If the intentional mislabeling of "short sales" as "long sales" done to circumvent expensive or unavailable borrows has been abused as the SEC asserts then what in the world is wrong with forcing the seller of shares that he claims he "owns" to note where these shares are currently being held especially when they're not being held at the selling firm? Besides people abusing these policies who would have a problem with incorporating this safeguard? If you really do "own" the shares you are selling then you must be housing it somewhere if it's not currently in the account of the selling b/d.)
While SIFMA firmly supports the Commission's attempts to address and prevent manipulative activity, SIFMA does not believe that enactment of a new anti-fraud rule that might have unintended consequences (Comment: especially if the "unintended consequences" include <u>finally</u> being forced to deliver that which you have previously sold and possibly being held <u>liable</u> for aiding and abetting in the selling of astronomic amounts of "pseudo-shares" and refusing to deliver that which you sold) is the most efficient means available to the Commission to achieve its goals. Rather, SIFMA believes that the better approach to address concerns about sellers engaging, or attempting to engage, in naked short selling through misrepresenting information is for the Commission to act upon the proposed amendments to the 1994 Prime Broker No-Action Letter ("Prime Broker Letter"). These amendments have been the subject of numerous discussions with the Staffs of both the

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[7] *See*, *e.g.*, *Sandell Asset Management Corp. et. al.*, Securities Exchange Act Release No. 8857 (October 10, 2007).

[8] The SEC had stated as follows in the Reg SHO Adopting Release: "A broker-dealer may obtain an assurance from a customer that such party can obtain securities from another identified source in time to settle the trade. (Comment: In other words an abusive hedge fund can cite that a 3rd party, undoubtedly beholden to the hedge fund for previous or future "kickbacks" or "back-scratches", has come forth and stated that it is in possession of shares that can serve as a "locate" and that they can be successfully delivered by settlement date. How many "3rd parties" on Wall Street might be willing to "serve" the hedge funds with their $10 billion in annual "juice" to spread around Wall Street in this capacity even though they have no shares whatsoever in the issuer involved? If this insanity is allowed then the checks and balances of tallying exactly what percentage of the "locates" provided by "X" 3rd party or received by "Y" short seller have resulted in FTDs is necessary. **<u>Until</u>** those safeguards are in place then "customer assurances" are no more than an invitation to defraud investors and easily bypass lending fees. This tallying process might be tough to do due to the obfuscatory role that the CNS "netting" process provides in identifying the exact account that fails to deliver originated in. Yet once again we see the need for darkness to commit frauds this obvious and this heinous. If our clearance and settlement system had one scintilla of **<u>transparency</u>** then what could possibly be more obvious of a crime than refusing to deliver that which you sell?) This may provide the 'reasonable grounds' required by Rule 203(b)(1)(ii). However, where a broker-dealer knows or has reason to know that a customer's prior assurances resulted in failures to deliver, (Comment: If something as subjective as "reasonable grounds" is allowed then the SEC must see that all FTDs are tallied and that all of the involved parties must be made aware of the FTDs.) assurances from such customer would not provide the 'reasonable grounds' required by 203(b)(1)(ii). The documentation required by Rule 203(b)(1)(iii) should include the source of securities cited by the customer. The broker-dealer also should be able to demonstrate that there are 'reasonable grounds' to rely on the customer's assurances, *e.g.*, through documentation showing that previous borrowings arranged by the customer resulted in timely deliveries in settlement of the customer's transactions." Securities Exchange Act Release No. 50103 (July 28, 2004), 69 FR 48008, 48014 (August 6, 2004). (Comment: How many market intermediaries were "busted" for these transgressions over the last 3 years? Note that the absurdity here is the failure to keep in mind that abusive b/ds ("3rd parties") will do anything in their power to access the $10 billion annually that hedge funds provide to those order executing b/ds and prime brokers willing to break the most amount of laws on behalf of the financial interests of the hedge fund manager. This obviously includes the provision of "DLs" ("Deceitful locates") or "DBs" ("Deceitful borrows"). A "deceitful locate"

or "deceitful borrow" is now a potent form of "currency" used on Wall Street because they result in the illegal circumvention of perhaps billions of dollars of borrowing and rental fees which serve as a natural built-in market deterrent to these abuses. "Deceitful locates" are as good as cash and should be treated similar to illegal bribes and/or "kickbacks". Do the practitioners of these crimes think of themselves as being involved in racketeering-related ("RICO") activities i.e. a form of "organized crime"? I don't think so. Somehow they assume that operating on Wall Street provides insulation from liability which is incurred in every other form of business excepting Wall Street. Mark Mitchell's treatise at deepcapture.com illustrates the ubiquitous nature of organized criminal activity found on Wall Street today. It's odd but there's just something about it occurring on Wall Street that makes it permissible. It probably has to do with the sparse nature of referrals from the SEC to the DOJ. Regulators don't seem to like other enforcement agencies operating on their "turf". As far as damages go note that those wishing to lend out their shares are also damaged by all of this fake supply of lendable shares which drives down the lending rates for legitimate shares. The "demand" variable for share lending is artificially manipulated downwards due to the circumvention of the need to borrow shares before short selling.

This isn't that complex; a party does something illegal/fraudulent in the form of providing DLs and DBs to an affiliated party. Its co-conspiring firm (perhaps a hedge fund) saves a fortune in stock loan fees. The hedge fund then directs lucrative prime broker business and order executing business as a way to say thanks for the illegal savings. The investors incur damages from about 10 different directions three of which are the diminishing share price, the voting power diminution associated with the back office cancellation necessary to cover up these frauds and the decreased potential income and opportunities from "renting" out their shares to others like legitimate short sellers.

I have the distinct feeling that the aiding and abetting as well as the racketeering aspect of these crimes are not very well appreciated by the perpetrators and enablers of these frauds, the regulators, the SROs and the DOJ. But shouldn't one intuit that being a part of a fraud based upon the refusal to deliver that which you sell would be associated with liability and the potential to be held accountable for acting as an accessory to a fraud this heinous and obvious. Common sense might dictate this in every form of business except perhaps that done on Wall Street where powerful people have a tendency to not be held accountable. Perhaps we saw this in the "Aguirre/Mack" case.

One would think that the supervisory procedures mandated by Reg SHO would be taken seriously by the Wall Street b/ds if for no other reason than to avoid aiding and abetting implications. Market participants are supposed to be keeping track of FTDs regardless of how the DTCC's CNS "netting" process works. Rule 10b-21 might prove to be the source of the heretofore missing meaningful deterrence to these crimes because the OCIE (Office of Compliance Inspections and Examinations of the SEC) reports that a lot of firms are simply not following the supervisory precepts of Reg SHO.) --------------------
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SEC and FINRA, and have been pending with the SEC for some time. Additionally, SIFMA believes that Section 10(b) of the Exchange Act and Rule 10b-5 thereunder already provide the Commission with ample authority to address manipulative or fraudulent trading activity. The Commission has, in fact, already utilized such authority to address naked short selling abuses.7 (Comment: Out of one side of their mouths the brokers and hedge funds say that the regulators are all over these crimes and no new rules are needed then out of the other side of their mouths (as you'll see in a moment) they'll claim that the SEC has only listed in the proposing release 3 cases that they aggressively pursued and thus the levels of these crimes must be nearly nonexistent and thus no new rules are necessary.)

To the extent the Commission still believes that a specific anti-fraud rule addressing naked short selling is necessary, SIFMA urges the Commission to provide clarification and address certain inconsistencies in the current language of proposed Rule 10b-21, as identified herein. SIFMA's comments, recommendations and responses to questions are provided in greater detail below.

II. Primary Recommendations to Address Naked Short Selling Concerns

a. Amend the Prime Broker Letter

Proposed Rule 10b-21 seeks to target situations where a customer misrepresents to its executing broker that it has obtained an away locate, or is a "long" seller. As the Commission is aware, in the prime brokerage context it is generally **"industry practice"** (emphasis added) for an executing broker to reasonably rely on a customer's representation that a locate on a "short" sale has been obtained with the customer's prime broker (*i.e.*, an "away locate"). This arrangement is not only expressly permitted under Reg SHO,[8] it is perfectly logical, since the prime broker generally bears responsibility for settlement of the customer's short sale. (Comment: In today's markets nobody is predictably being held "responsible" for FTDs and that's the crux of the issue) It is also **"industry practice"** (emphasis added) in the prime brokerage context for an executing broker to reasonably rely on a customer's representation of a "long" sale, in that the customer's positions are held away at the prime broker. (Comment: Note the argument being built to allow this **"industry practice"** of creating a daisy chain of hedge funds feeding business to order entry b/ds (OEBDs) or "executing" b/ds that are allowed to "assume" that the prime broker involved has taken care of any "locates", "pre-borrows" or "ownership" issues. Why should these fraud-promoting and fact obfuscating daisy chains of "assumptions" be allowed to persist? It's because they are **"industry practice"** silly. True, but issuers remaining on the "Threshold list" for over 800 days is also **"industry practice"** but that doesn't make it legal. (Recall that Reg SHO left it up to the OEBDs to determine "reasonable grounds" to believe delivery would be made by T+3. Reg SHO unfortunately allowed "customer assurances" from the short sellers to qualify as "reasonable grounds". It also allowed the presence of the issuer on unregulated "easy to borrow" lists to qualify for "reasonable grounds". The flimsy wording of Reg SHO in these instances is why Rule 10b-21 is even necessary.) In other words let's just put everybody on the "honor system" and everything will be OK. Each member of the "daisy chain" is bequeathed with "plausible deniability" that circumvents "scienter" such that they have the ability to point fingers and say "Well, I assumed the prime broker or executing b/d or hedge fund took care of the locate". After all it's **"industry practice".**

The problem the SEC is trying to deal with is that for many abusive SIFMA and DTCC members "abusive naked short selling" has also become **"industry practice".** Abusive hedge fund managers need market intermediaries like OEBDs and prime brokers to be willing to act oblivious to this "deceit" in exchange for order flow. That's why aiding and abetting crimes need to be a part of the overall regulatory structure to deter this type of behavior. That's what an uncompromised congressionally-mandated provider of investor protection and market integrity (the SEC) does on behalf of the U.S. investing public they serve. The brokerage firms and the hedge funds have their "SIFMAs" and "MFAs" to present their cases to maintain the corrupt status quo. All the investors have is the SEC to provide investor protection and market integrity as the foundation for a fraud-free status quo.) 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** (emphasis added) the executions of clients' legitimate orders. (Comment: Translation: "Let's maintain the corrupt status quo for illegitimate sell orders in order to avoid **"delays in the execution of legitimate orders".** What constitutes "reasonable reliance" on customer representations? It would obviously be anything that has become **"industry practice"** silly! How does one "reasonably rely on customer representations" when the "customer representation" involves the mere submission of a sell order that history has proven is chronically abused? What was Reg SHO all about?

How does putting on a blindfold to these crimes jive with SIFMA's mission statement of "preserving and enhancing the public's trust and confidence in the markets and the industry." Here arrives the much anticipated "This is the efficient way to do it" because the trading on Wall Street moves so fast and sometimes there just isn't time for the provision of investor protection and market integrity. The goal is not to "needlessly delay the executions of clients' legitimate orders." 9 The goal is to address the illegitimate orders that have now become **"industry practice"** due to the existence of the "ultimate paradox".) Furthermore, a prohibition on away locates would be severely detrimental to

9 The SEC specifically asked about such reliance, stating as follows in the Proposing Release: "In the 2004 Regulation SHO Adopting Release, the Commission stated that a broker-dealer could satisfy the locate requirement of Regulation SHO by obtaining an assurance from a customer that the customer can obtain securities from another identified source in time to settle the trade, provided the broker-dealer reasonably believes the customer's assurance. Proposed Rule 10b-21 is aimed, in part, at sellers who make misrepresentations to their broker-dealers about their locate sources. Should we instead no longer permit a broker-dealer to rely on such customer assurances in satisfying the locate requirement of Regulation SHO? (Comment: Absolutely yes when prior FTDs were the result of prior "customer assurances". Is anybody keeping a tally on which "customer assurances" have been proven to be bogus or is it **"industry practice"** not to keep a tally?) What would be the costs and benefits of removing the ability of broker-dealers to rely on such customer assurances? (Comment: Benefit-a less corrupt status quo) What would be the impact on market participants (such as broker-dealers, stock lenders, investors)? (Comment: The corrupt ones are going to be selectively affected and might have to learn how to make a living without committing fraud.) Would smaller entities be affected more or less adversely than larger entities?"

10 With respect to "long" sales, the proposed new Prime Broker Letter generally places an obligation on the prime broker to determine whether a customer owned securities that were executed "long" at an executing broker, and advise the executing broker, through the Omgeo system, on situations where the customer did not in fact own the securities sold. With respect to "short" sales, the new Prime Broker Letter generally places an obligation on the prime broker to review information received from the executing broker regarding a customer short sale. If the prime broker does not have a record of providing a locate to the customer, and cannot borrow the security, then the prime broker must contact the customer to determine the source of the locate, and also contact such source to confirm that a locate was provided to the customer and attempt to borrow such security. In the event that the source identified by the customer does not have a record of providing a locate to such customer, or does have such a record but does not deliver the shares on settlement date, then the prime broker is required to advise the executing broker of this fact, again through the Omgeo system.

small executing brokers that may not have comparable access to a large stock loan supply. (Comment: Translation: Let's throw out any integrity to the clearance and settlement system because small b/ds have a tougher time finding stock loans and we wouldn't want to put them at a disadvantage. Note the fishing expedition for access to the "Adverse effects on small entities issues" that the SEC is mandated to monitor. We can't have investor protection, market integrity and a noncorrupt status quo because it wouldn't be fair to the smaller broker/dealers.)

This being the case, SIFMA believes that the Commission already has in its possession sufficient means to address potential customer misrepresentations to executing brokers in the form of the revised Prime Broker Letter. As the Commission is aware, the industry, through the SIFMA Prime Brokerage Committee, has engaged in extensive collaborative efforts with the Staffs of both the SEC's Division of Trading and Markets and FINRA regarding revisions to the Prime Broker Letter. These revisions are intended to enhance communications between the prime broker and executing broker and to help ensure that the customer is providing accurate information to the executing broker.10

While implementing the requirements of the new Prime Broker Letter will necessitate both executing brokers and prime brokers engaging in extensive systems modifications, SIFMA firms generally support the clarity and guidance that it will provide on the application of Reg SHO in the prime brokerage context. Specifically, the revised Prime Broker Letter will create a mechanism for prime brokers and executing brokers to seamlessly communicate such information concerning customer "long" sales and "short" sales, through the Omgeo system. (Comment: The SEC should obviously be a little suspicious of the reaching out to access the DTCC-associated Omgeo system.)This mechanism is otherwise not presently available.

b. Utilize Existing Authority Under 10(b) and Rule 10b-5
While clearly well-intentioned, SIFMA believes proposed Rule 10b-21 is unnecessary because the Commission already has ample existing authority, under Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, to prosecute manipulative and/or fraudulent activity, including the type of activity that proposed Rule 10b-21 seeks to address. (Comment: Perhaps, but when scienter is mandated to create liability then <u>specific</u> delineations of what exactly is to be deemed as being "unlawful" is necessary so that abusers can't respond that they had no idea that this behavior was unlawful. After all who'd have ever thought that selling securities to unknowing investors, taking their money, merely collateralizing the debt and then refusing to deliver that which you sold could be deemed unlawful?)

Moreover, creating a new anti-fraud rule specifically targeted at naked short selling may create uncertainty and confusion (Comment: I really don't see the "uncertainty and confusion" associated with market professionals that after inordinate amounts of time constantly refuse to deliver that which they sell.) For example, market participants would

11 Specifically, Exchange Act §§ 2, 3(b), 6, 9(h), 10, 11A, 15, 15A, 17, 17A, 19 & 23(a), 15 U.S.C. §§ 78b, 78c(b), 78f, 78i(h), 78j, 78k-1, 78o, 78o-3, 78q, 78q-1, 78s & 78w(a).

12 "Concerns with the judicial creation of a private cause of action caution against its expansion. The decision to extend the cause of action is for Congress, not for us. Though it remains the law, the § 10(b) private right should not be extended beyond its present boundaries. . . . It is appropriate for us to assume that [when it enacted the Private Securities Litigation Reform Act of 1995], Congress accepted the § 10(b) private cause of action as then defined but chose to extend it no further." *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 128 S. Ct. 761, 773 (2008).

13 *Id.* at 768. *See also United States v. O'Hagan*, 521 U.S. 642, 651 (1997) ("Liability under Rule 10b-5 . . . does not extend beyond conduct encompassed by § 10(b)'s prohibitions."); *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 175, 177 (1994) ("[T]he statutory text controls the definition of conduct covered by § 10(b) . . . [it is] inconsistent with settled methodology in § 10(b) cases to extend liability beyond the scope of conduct prohibited by the statutory text."); *Santa Fe Indus., Inc. v. Green*, 430 U.S. 462, 473-74, 475 n. 14 (1977) (a "complaint states a cause of action under any part of Rule 10b-5 only if the conduct can be fairly viewed as 'manipulative or deceptive' within the meaning of the statute.").

14 *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 212-214 (1976).

15 *Id.* at 213-14. The Court reaffirmed this conclusion in *Aaron v. SEC*, 446 U.S. 680, 690, 695-97 (1980), which held that scienter is not required under §§ 17(a)(2) & (3) of the 1933 Act – while those statutes use the same language as Rule 10b-5(b)&(c), the Court reached a different outcome than in *Hochfelder* because the language was contained in the statutes themselves.

16 *See, e.g., Arst v. Stifel, Nicolaus & Co.*, 86 F.3d 973, 977 (10th Cir. 1996) (claim under Rule 10b-10 dismissed for failure to meet statutory "in connection with" requirement); *Angelastro v. Prudential-Bache Secs., Inc.*, 764 F.2d 939, 946 (3d Cir. 1985) (Rule 10b-16 claim must meet statutory "in connection with" requirement); *Robertson v. Dean Witter Reynolds, Inc.*, 749 F.2d 530, 540 (9th Cir. 1984) (claim under Rule 10b-16 must satisfy statutory scienter requirement). *See also Morris v. Wachovia Secs., Inc.*, 277 F. Supp. 2d 622, 638 n. 9 (E.D. Va. 2003) (dismissing Rule 10b-10 claim for failure to allege statutory elements of reliance and loss causation); *Bissell v. Merrill Lynch & Co.*, 937 F. Supp. 237, 245 (S.D.N.Y. 1996) (dismissing Rule 10b-16 claim for failure to allege statutory "in connection with" requirement and statute of limitations), *aff'd on other grounds*, 157 F.3d 138 (2d Cir. 1998); *Levitin v. PaineWebber, Inc.*, 933 F. Supp. 325, 330-31 (S.D.N.Y. 1996) (dismissing Rule 10b-10 and 10b-16 claims for failure to allege statutory "in connection with" requirement), *aff'd on other grounds*, 159 F.3d 698, 707 (2d Cir. 1998). *Cf. Greenblatt v. Drexel Burnham Lambert, Inc.*, 763 F.2d 1352, 1358 n. 8 (11th Cir. 1985) (noting that any cause of action under Rule 10b-16 would need to meet statutory elements). (Comment: Note above that somebody put in a lot of legal hours just to make the argument that "highlighting the liability" of behavior already deemed to be unlawful is not necessary. Just how much money is at stake here if these abusive naked short positions might need to be covered or if future thefts might be reduced?)

not only need to consider the parameters and interpretations of new Rule 10b-21, but new questions might also be raised whether other types of activity might be actionable under the general provisions of 10(b), given that the Commission has not decided to address such activity in a separate 10(b) rule. (Comment: Now we're cutting to the chase and the need for SIFMA to file this "comment letter" while proffering some of these incredible arguments in favor of what most would deem to be grossly fraudulent activity. Note all of a sudden there is concern that "other types of activity" associated with abusive naked short selling (ANSS) and delivery failure related abuses (DFRAs) might now be considered "actionable" wherein the victims (perish the thought) of this theft might have access to private rights of action. We sure wouldn't want that after decades of this behavior being **"Industry practice".)**

SIFMA is also concerned that the creation of the proposed new anti-fraud rule might create uncertainty as to whether courts would similarly interpret in the Rule 10b-21 context the precedent that has been established with respect to Section 10(b) and Rule 10b-5 thereunder. For example, although the Proposing Release does not specifically address private rights of action for violation of proposed Rule 10b-21, a question on this point was raised at the Commission's Open Meeting on the Rule. SIFMA notes, in this regard, that Congress has not provided any express cause of action for private citizens to sue for civil damages for violation of proposed Rule 10b-21, nor for violations of any of the provisions of the Exchange Act cited by the Commission as authority for the Rule.[11] Accordingly, any authority for a private right of action must be found in the judicially implied right of action under Section 10(b) but, as the Supreme Court has emphasized, that right of action cannot be expanded without authorization from Congress.[12]

As the Court has repeatedly emphasized, "Rule 10b-5 encompasses only conduct already prohibited by Section 10(b)."[13] The Court has expressly held that the Commission lacks authority to expand the scope of the private right of action when it held that scienter is required for all Section 10(b) private actions even though the language of subparts (b)&(c) of Rule 10b-5 "could be read as" imposing liability "whether the wrongdoing was intentional or not."[14] "The rulemaking power granted to an administrative agency charged with the administration of a federal statute is not the power to make law . . . [t]hus, despite the broad view of the Rule advanced by the Commission in this case, its scope can not exceed the power granted the Commission by Congress under Section 10(b)."[15] (Comment: You can see that the legal arguments have already been drawn up in regards to private rights of action for this crime wave.)

Following this guidance, the courts have repeatedly held that, because any implied right of action under Rules 10b-10 and 10b-16 would have to arise from Section 10(b), it must satisfy all of the elements of the Section 10(b) implied right of action.[16] Because proposed Rule 10b-21 similarly depends upon the implied Section 10(b) cause of action as authority for the imposition of private civil liability in the absence of express authorization by Congress, it should similarly be expressly subject to all of the requirements of a Section 10(b) claim and the PSLRA, including pleading and proof of reliance, scienter, materiality, loss causation, damages, standing and a manipulative or deceptive device employed in connection with the purchase or sale of securities. (Comment: As opposed to worrying about private rights of action and aiding and abetting issues wouldn't it be easier to just deliver that which you sell in a timely manner? The monetary rewards for this fraudulent behavior apparently is so great that the risk/reward analysis dictates it prudent to not refrain from these activities but instead to mitigate the risk variable via thwarting the introduction of new laws expressly deeming these activities as being "unlawful". Besides the perpetrators of these frauds who else would show so much concern for the mere "highlighting the liability" of this behavior which is already forbidden by 10b-5? I told you that you can learn a lot about the mindset of the brokerage industry from these "comment letters" that need to be made public.)

III. Secondary Recommendation – Adopt Modified Version of Anti-Fraud Rule

To the extent the Commission still believes that an anti-fraud rule addressing naked short selling is necessary, SIFMA encourages the SEC to resolve to address certain inconsistencies in the current form of proposed Rule 10b-21, as well as clarify related issues, as identified below.

a. Amend Rule's Current Focus on "Seller's Fail"

Proposed Rule 10b-21, as drafted, would be violated if the following occurred: (1) a seller of a security deceives a broker-dealer, participant of a registered clearing agency, or purchaser regarding its intention or ability to deliver the security sold on the date delivery is due; (2) *the seller fails to deliver the security sold*; and (3) the seller acts with scienter. As the Staff is aware, the seller's clearing firm, rather than the seller, will generally bear the obligation to meet its CNS delivery requirement, and thus SIFMA recommends that the Rule instead focus on whether there is a CNS fail, (Comment: You had to know this was coming. If an FTD is necessary to be held liable then let's make it a "CNS fail" instead of a regular FTD. Now why would a trade group of b/ds make this rather odd request? Could it be because:

A) "CNS netting" reduces by 96% the number of FTDs tallied.
B) Access to the self-replenishing and non-decrementing "Automated Stock Borrow Program" (SBP) of the DTCC.
C) Access to the DTCC managements pleading to be "powerless" to buy-in FTDs.
D) Access to the 2,000 pages of self-serving rules and regulations of the DTCC and NSCC which the SEC is forbidden by Section 19 C of the '34 Exchange act to add to or delete from.
E) Access to the DTCC's mindset that "Collateralizing" a debt is good enough to qualify as "settlement" of a transaction.
F) Access to the DTCC management's contention that a trade can "settle" even though it has not "concluded" yet.

while also maintaining the requirement that the broker-dealer be deceived, and the seller act with scienter. In this regard, SIFMA notes the Commission's prior recognition that, because NSCC's continuous net settlement system ("CNS") nets all buys and sells in each security, broker-dealers cannot readily determine which customer's transaction or

17 The Commission had stated as follows in the 2004 Reg SHO Adopting Release: "Some commenters argued that under the confines of current settlement practices and procedures, it is not practical to assign delivery failures to a particular clearing firm customer account. It was noted that because NSCC's continuous net settlement ('CNS') system nets all buys and sells in each security for each NSCC participant, broker-dealers cannot determine which customer's transaction or account gave rise to a failure to deliver." Securities Exchange Act Release No. 50103 (July 28, 2004), 69 FR 48008 (August 6, 2004).
18 "Would the inclusion of a fail to deliver as an element of the proposed rule encourage broker-dealers, as a service to customers, to deliver securities on behalf of customers to prevent customers from failing to deliver securities by settlement date? Would broker-dealers feel any additional obligation to purchase or borrow securities on behalf of their customers to deliver on a customer's sale?"
19 69 FR at 48016.
20 Proposing Release, 72 FR at 15377.

account gave rise to a fail-to-deliver. [17] (Comment: Well isn't that handy for the criminals perpetrating these frauds! The accounts from which the crimes are being committed are not "readily identifiable" due to CNS "netting". This reality is the prime argument for mandated buy-ins as the bill for the buy-in will "readily identify" the account holder because the "enabling" OEBDs and prime brokers are sure not going to spring for the check! Mandated buy-ins act like "heat-seeking missiles" that always land in the lap of the fraudster refusing to deliver that which he sold. If a purchaser of securities failed to pay his bill do you think that he could get away with it because he can't be "readily identified". Again we see the need for near total darkness to pull off a crime as obvious as refusing to deliver that which you sell and yet still being granted access to the purchaser's funds.)

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.

(Comment: Oh I had no idea all of the sales my firm has been making were resulting in FTDs. I guess we weren't "monitoring" our CNS FTDs very well. Good idea; let's just concentrate on the impossible to identify (due to CNS "netting") accounts of unregulated hedge fund sellers instead of those that aid and abet these crimes in exchange for order flow. Let's also allow the CNS fail-to-deliver position that masks 96% of FTDs to provide our yardstick to judge our fraudulent behavior. Imagine the clearing firms claiming that they had no idea which one of their clients was running up all of those FTDs due to CNS "netting".)

SIFMA also notes that the Commission raised a question in the Proposing Release as to whether the inclusion of a fail as a necessary element of the proposed Rule would encourage broker-dealers to deliver securities to prevent customers from failing.[18] As a general matter, a participant broker-dealer will attempt to deliver securities to satisfy its CNS delivery obligation, which may reflect both long sale and short sale activity. Given the fungible nature of securities in CNS, any transfer of securities from a participant broker-dealer's DTC account to NSCC's account at DTC to cover a CNS delivery obligation may, and for most larger broker-dealers will, include borrowed securities. (Comment: so much for the DTCC's claim that the SBP is seldom used.) As the Commission is aware SIFMA has pending a long-standing no-action request which would clarify that a broker-dealer borrowing securities in this manner to satisfy its bulk settlement obligations does not constitute a violation of Rule 203(a) of Reg SHO. SIFMA would strongly encourage the Commission to take the opportunity here to confirm the guidance that would be provided by this request. (Comment: Here the commenters are referring to the use of the DTCC's "Automated Stock Borrow Program" or "SBP" which is insanely allowed to act in a self-replenishing manner. The request here is for failures to deliver that are addressed or "cured" by a borrow from the self-replenishing SBP to not count as a FTD which the proposed Rule 10b-21 mandates be involved to create liability along with scienter and the use of deceit. Any abusive SIFMA members or DTCC participants are of course going to want to hide their fraudulent behavior by accessing the ability of the CNS "netting" process to mask the delivery status of 96% of transactions and the ability of a self-replenishing lending pool like the SBP to mop up most of the rest.

The question is why is SIFMA a conglomeration of 650 b/ds going so far out of their way to selectively protect their abusive members perpetrating these frauds while the bulk of its constituents (hopefully) choose to play by the rules. Where is the outrage from the ethical SIFMA brokerage firms not partaking in these crimes? Are these crimes so pandemic that basically every brokerage firm is partaking? Administering a lending pool of securities in which the purchasing b/d being delivered borrowed shares can replace those shares right back into the same lending pool from which they just came <u>as if they never left in the first place</u> is nothing short of criminal yet the SEC that approved the SBP many years ago is willing to file amicus briefs stating that the SBP is just fine and dandy. This results in the same parcel of shares, if they were readily identifiable which thank goodness for the fraudsters they aren't due to anonymous pooling, being simultaneously loaned out and gaining rental income from perhaps a dozen different directions simultaneously.)

b. Limit to Threshold Securities

In response to the SEC's question, SIFMA believes that Rule 10b-21 should be narrowly-tailored to <u>**only**</u> (emphasis added) cover Threshold Securities. In focusing on Threshold Securities, for purposes of the Reg SHO close-out requirement, the SEC had specifically indicated in the 2004 Reg SHO Adopting Release that "This narrowly targeted threshold will not <u>**burden**</u> (emphasis added) the vast majority of securities where there are not similar concerns regarding settlement," (Comment: the securities of all corporations find no "burden" in the proposed "highlighting the liability" of unlawful behavior. On the contrary they find it a blessing when the SEC bestows investor protection on their shareholders.) noting further that "imposing a lower threshold or, as suggested by some commenters, prohibiting all fails, might be an impracticable or an overly-broad method of addressing any potential abuses, and could also disrupt the efficient functioning of the Continuous Net Settlement System…"[19] SIFMA believes these same rationales warrant limiting Rule 10b-21 to only Threshold Securities. (Comment: Why wouldn't all U.S. domiciled corporations and the investors therein be given access to protection from clearly fraudulent behavior?) As was indicated in the Release, fails-to-deliver generally occur in less than 1% of all transactions,[20] and therefore applying Rule 10b-21 to all securities would neither be necessary or prudent.[21] (Comment: This 1% figure proffered by the DTCC has been disproven by many academics. Citing it as being truthful after papers have been published proving its false nature is disingenuous at best. The failure to count FTDs in ex-clearing arrangements and the effects of CNS "netting" make these use of these statistics disingenuous at best.

"Although the proposed rule is primarily aimed at sellers that deceive specified persons about their intention or ability to deliver shares or about their locate source and ownership of shares, as with any rule, broker-dealers could be liable for aiding and abetting a customer's fraud under the proposed rule. In addition, broker-dealers would remain subject to liability under Regulation SHO and the general anti-fraud provisions of the federal securities laws." *Id.* (Comment: Actually I think the proposed rule is aimed at both those short sellers doing the deceiving about "ownership" issues and the ability and intent to deliver and those market inteermediaries intentionally standing ready and willing to be "deceived" in exchange for order flow and a portion of the $10 billion in annual payments made to those market intermediaries serving hedge funds.)

c. Scienter Requirement

SIFMA understands that, although the manipulative short selling activity that Rule 10b-21 is intended to address may already be actionable under 10(b) and Rule 10b-5, the Commission believes that a rule "highlighting the illegality of these activities would focus the attention of market participants on such activities." This being the case, SIFMA requests the Commission's confirmation that the concept of scienter, for purposes of Rule 10b-21, be identical to established precedent under 10(b) and Rule 10b-5 thereunder. (Comment: The concept of scienter under 10(b) and 10b-5 is written very favorably for the perpetrators of fraud and accessing it would be a bonus for those choosing to perpetrate these frauds. This is why 10b-21 needs to specifically list out a myriad number of activities associated with ANSS and DFRAs deemed to be unlawful so that criminals can't plead to have had no idea that selling securities without ever delivering them caused damages and involved victims. Whoda thunk?)

d. Clarify Broker-Dealer' Aiding and Abetting Liability

By targeting situations where a customer misrepresents to its executing broker that it has obtained an away locate, or is a "long" seller, proposed Rule 10b-21 may assist an executing broker in meeting its requirement to have "reasonable grounds" to believe the customer is providing accurate information. This being the case, the SEC indicated in the Proposing Release that an executing broker in such situation might still be primarily liable, under Regulation SHO, or secondarily liable for aiding and abetting a violation of Rule 10b-21.[21] SIFMA is troubled by the Commission's statements in the Proposing Release, and believes that they introduce uncertainty for broker-dealers with respect to their compliance obligations under proposed Rule 10b-21. (Comment: There is no uncertainty involved. If you don't intentionally allow yourself to be "deceived" in exchange for order flow and fees then you won't be held liable." Maybe just maybe the supervisory procedures mandated by Reg SHO

should be instituted instead of avoided as the SEC's "OCIE" (Office of Compliance Examinations and Examinations) has learned is being done by the brokerage community.)
Proposed Rule 10b-21 specifically applies to sellers, who are best postured to know their own obligations and ensure compliance therewith. While SIFMA recognizes that broker-dealers cannot turn a blind eye to illegal activities (Comment: especially when it makes them a fortune in illicit funds.) by their customers, broker-dealers should not be held responsible for policing their customers' compliance with their own legal requirements. (Comment: Unregulated and offshore hedge funds by definition don't have a lot of "legal requirements" to follow. That's why some of the more abusive ones operate in that fashion and violently fight any measure to force their regulation. A crime as obvious and as heinous as refusing to deliver that which you sell needs a backdrop of darkness in order to be pulled off. Allowing "away locates" to qualify as "reasonable grounds" and then claiming that OEBDs and prime brokers should be able to "assume" that each other is doing their respective jobs and that hedge funds are regulating themselves is an invitation for fraud. If the OEBD was the prime broker then responsibility would clearly rest on the shoulders of the prime broker. Allowing the creation of a daisy chain of "assumers" is nonsense.)
Furthermore, because proposed Rule 10b-21 contains as a key element the fact that the seller deceive the broker-dealer, it is unclear in what situations a broker-dealer would know of, and aid and abet a violation. (Comment: the clear history of prior FTDs associated with prior "locates", "pre-borrows", "customer assurances", "reasonable grounds", etc. with this party obviously needs to be supplied by the regulators and SROs to these market intermediaries. A paperwork system similar to the "SARs" or "Suspicious Activity Reports" might be considered.) SIFMA would therefore urge the Commission to reconsider its statements concerning broker-dealer's liability for aiding and abetting. (Comment: The aiding and abetting aspect is necessary because of the gigantic opportunity for financial gains available to those abusive market intermediaries like order executing b/ds and prime brokers that intentionally allow themselves to be "deceived". Abusive hedge funds will actively seek out and shower with financial gains those willing to be "deceived". The circumvention of perhaps billions of dollars of lending fees associated with hard to borrow securities or the unavailability of borrows in some securities creates a very strong temptation to break the law. Recall that the typically targeted corporations in this crime wave are development stage corporations with hard to borrow and nonmarginable securities associated with little institutional ownership and few shares held in margin accounts. The "order flow" directed to those willing to be "deceived" operate more like "kickbacks" in racketeering activities.)
As noted above, SIFMA believes that the best approach to address concerns about sellers engaging, or attempting to engage, in naked short selling through misrepresenting information is for the Commission to act upon the proposed amendments to the 1994 Prime Broker No-Action Letter.

e. "Long" Sales by Firm Aggregation Units

22 Specifically, the Commission noted in a prior Amicus brief that: "The fact that a broker-dealer that is an NSCC member fails to receive securities that it purchased on behalf of a retail customer does not mean that the customer's purchase is not completed (Comment: "the completion of a purchase" has nothing to do with good form delivery and therefore the mandated "prompt settlement" of a transaction) until the member's failure to receive is cured. Under Article 8 of the Uniform Commercial Code, a securities broker may credit a customer's account with a security even though that security has not yet been delivered to the broker-dealer's account by NSCC. In that event, the customer receives what is defined under the Uniform Commercial Code as a securities entitlement,' which requires (Comment: The granting of a "securities entitlement" has nothing to do with the "prompt settlement" of a trade. UCC Article 8 does not "require" or allow the DTCC or any market intermediary to create any "right" within the "package of rights" that

constitutes a share. "Entitlement holders" are, however, allowed to sell her or his "securities entitlement" as if it were a legitimate share. Why? Because they were anticipated by the legislators at the time to have an ultra-short lifespan and were designed to serve as a "Placeholder" security until the imminent delivery was made. Fraudsters have merely converted the right to grant ultra short term "securities entitlements" into the right to pick the pocket of unknowing investors relying on the SEC to provide investor protection. How were they able to do that? It was because neither the SEC nor the DTCC monitored for the age and amount of "securities entitlements" building up within the share structures of targeted issuers as was presumed by the legislators granting the right to create "securities entitlements".) the broker-dealer to treat the person for whom the account is maintained as entitled to exercise the rights that comprise the security." *See Nanopierce Technologies, Inc. vs. The Depository Trust and Clearing Corporation* , Supreme Court of Nevada, Case No. 45364, Brief of the Securities and Exchange Commission (February 2006).

Although the Proposing Release indicates that broker-dealers acting for their own accounts would be considered "sellers," for purposes of Rule 10b-21, SIFMA would request the Commission's clarification that a violation of Rule 10b-21 would not occur where an aggregation unit within a broker-dealer marks a sale "long," based on its net position, however, due to other CNS activity, the broker-dealer may have a CNS fail-to-deliver position. Rather, in order for a potential violation of Rule 10b-21 to occur, the aggregation unit would need to be engaging in deception, and also acting with scienter. (Comment: Yet once again we see the request to be able to access the shortcomings of the CNS "netting" system and leave any and all loopholes associated with Reg SHO (like the "aggregation" rules intact. Note the reticence to even touch the subject of FTDs held in ex-clearing "arrangements".)

f. Clarify Coverage of "Purchasers" Under Rule 10b-21

The current language of proposed Rule 10b-21 indicates that it shall be a violation for a seller to deceive "a purchaser" about its intention or ability to deliver the security on the settlement date. SIFMA notes that, in the event that a person purchases securities, but their broker-dealer may have a CNS fail-to-receive, such person is still deemed to be **<u>an</u>** (emphasis added)owner (Comment: Note the Freudian slip. The purchaser becomes **"an"** owner of the securities in question i.e. one of many not "the" owner of that particular parcel of shares. Section 17 A of the '34 Exchange Act, however, mandated the "transfer of ownership" during a securities transaction.) of such securities, and is entitled to exercise **<u>all</u>** (emphasis added) rights of ownership, including selling the position. (Comment: This statement is absolutely incorrect. The "Entitlement holder" that purchased shares involved in an FTD is not entitled to exercise <u>ALL</u> rights of ownership ascribed to ownership. For example, the DTCC has no statutory power to create new voting rights out of thin air. That's why back offices need to indiscriminately cancel voting rights of shareholders of heavily naked short sold corporations. The concept of doing business as a U.S.-domiciled "corporation" with strictly defined voting rights came first. The trading of the shares of a "corporation" came later. **The DTCC is not "mandated" to treat all "purchasers" of shares as "owners" of shares.** This misconception provides one of the pillars for this whole family of abuses.

Granted that those short an issuer's shares must match cash dividend rights by making "PILS" or "Payments in lieu". Note that these "PILS" do not qualify for beneficial tax treatment by the IRS although all of the purchasers of both real and bogus shares that never got delivered expect this preferential tax treatment. Some "rights" within the "package of rights" that constitutes a "share" of a corporation are substitutable without redefining the concept of a "corporation". These include the rights to sell and receiving matching cash and share dividends. Others are not and they include the right to vote your shares. DTCC participants have permission to create and credit ultra-short termed "securities entitlements" to the accounts of purchasers of shares where a legitimate FTD occurred. They have no right whatsoever to create any "rights" that are non-substitutable and that redefine the substance of a corporation especially when those "sharing the ownership" of a given parcel of shares have not been forewarned about these issues. Investors don't realize it but the existence of unaddressed and archaic FTDs hidden all around Wall Street has rendered the "One share, one vote" foundation of a U.S. corporation a myth.

In the matter of share dividends or "dividends in kind" all the DTCC does is to create a new electronic book entry IOU for yet more "Share entitlements" without voting rights even though the dividend distributed by the corporation was for legitimate "Shares" with all of its individual rights within this "package of rights" attached. This "Freudian slip" was very revealing. The DTCC participants and SIFMA brokerage firms want the right to essentially "counterfeit" securities and allow multiple "ownership" of a given parcel of shares. This approach is obfuscated by a variety of factors including the fact that shares held in "street name" are held in an anonymously pooled format where specific ownership is indeterminable. The fact that "CEDE and Co., the nominee of the DTCC, is technically the legal owner of all "street name" shares also provides cover for these crimes and "ownership" issues.)

Therefore, despite the fact that some commenters may allege that fails-to-deliver result in the purchaser of the securities paying for shares, but never receiving them (*i.e.*, there are allegations made that these are "phantom shares"), (Comment: the concept of a "phantom share" or "counterfeit share" might be visualized as the result of a FTD or "securities entitlement" that has not been addressed within the time period envisioned by the legislators that allowed the creation of ultra short termed "securities entitlements" or "placeholder securities" for FTDs that couldn't quite be delivered by settlement date. I liken it to the result of a "refusal to deliver" (RTD) which is an FTD older than T+13. Since an "evidence of indebtedness" qualifies as a "security" then these "phantom shares" which are indeed an "evidence of indebtedness" are "securities" under the purview of the SEC even though they are not legitimate "shares" representing a "unit of equity ownership". A "securities entitlement" is actually more of an accounting term.) the Commission has previously noted that this assertion is simply not accurate.22 (Comment: It is 100% accurate as mere non-voting "Share entitlements" are not legitimate "Shares" of a U.S. domiciled issuer. They are supposed to be merely an ultra-short lived "Placeholder security" created when the "prompt and accurate clearance and settlement" of a transaction was temporarily delayed for a legitimate reason only and not in association with clearly fraudulent activity-see Addendum C to the rules and regulations of the DTCC and UCC Article 8.)

SIFMA is concerned that the extension of proposed Rule 10b-21 to "purchasers" may subject broker-dealers to meritless civil litigations that would impose tremendous costs to defend. The end result could be a chilling effect on legitimate short selling, (Comment: Legitimate short selling involving a decrementing and documented "borrow" are extremely critical for "pricing efficiency" but has nothing to do with the frauds being addressed here. By definition, "legitimate" short selling does not involve deceit, an FTD or scienter.) which as the Commission has noted, provides numerous benefits to the market, including: (i) countering unwarranted, speculative upward price pressure in stocks, (Comment: Translation: Even though we might be practicing a form of racketeering that allows us to steal the funds of investors hand over fist we do provide a deterrent on "pump and dump" frauds. Here we see the obvious but natural obsession that those holding large unaddressed naked short positions would have with "upward price pressure". We have the ability to counter "pump and dump" frauds has long been the war cry of the abusive naked short seller. That leaves an interesting paradox; let's fight **suspected** "pump and dump" frauds with blatant acts of racketeering. That'll teach 'em.) and even uncovering and exposing fraudulent issuer activities; (ii) enabling a person to hedge the risk of a stock position owned, and thereby protect against a price decline; (iii) providing liquidity in response to buyer demand; (iv) providing latent buying interest; and (v) facilitating efficient markets. (Comments: "Efficient markets" don't have issuers with inordinate amounts of incredibly damaging securities entitlements poisoning their share structure and forcing their share prices downwards.)

SIFMA would therefore request that the Commission either remove the concept of deceiving a "purchaser" from Rule 10b-21, or clarify that 10b-21 would only apply in the event that a purchaser was deceived in the course of direct communications with a seller, and where such transaction settles outside of the Continuous Net Settlement System ("CNS"). (Comment: Translation: Let's either get rid of the concept of protecting the deceived purchasers of shares or at least let's not address the deceit of purchasers occurring at the DTCC where the lion's share is occurring. Just because the purchaser of shares does not have "direct communications" with the seller because of the nature of markets has nothing to do with the fact that he is a victim of intentional fraud and has incurred damages. The criminal doesn't need to look you in the eye to rip you off. The transactions that settle "outside the Continuous Net Settlement System ("CNS")" pseudo-settle in ex-clearing formats where Reg SHO doesn't even apply and the legal "settlement" of a transaction involving "good form delivery" of that purchased can be stalled interminably. The "purchaser" already fulfilled his half of the contract but has been blinded to the fact that the seller did not perform on his half. The purchaser's "agent" that took a commission and has a duty of care is also often blindfolded to this fact. Due to the anonymous pooling of shares held at the DTCC the "purchasers" don't realize that they have been individually defrauded but it's not necessary to identify each defrauded investor as the entire shareholder base has been defrauded and damaged by these incredibly damaging "securities entitlements" diluting the share structure of the victimized corporation. In reality, whether the purchaser's FTD is hidden in a DTCC "C" sub account or in ex-clearing "arrangements" the "purchaser" doesn't have a clue that he's been defrauded because he has visibility of the mere "securities entitlement" on his brokerage statement that he mistakenly thinks is a real share with voting rights.)

[23] Securities Exchange Act Release No. 56213 (August 7, 2007), 72 FR 45558 (August 14, 2007).
[24] Securities Exchange Act Release No. 57511 (March 17, 2008), 72 FR 15376, 15379 (March 21, 2008).
[25] As you know, Rule 200(a) defines a "short sale" as "any sale of a security which the seller does not own or any sale which is consummated by the delivery of a security borrowed by, or for the account of, the seller." 17 C.F.R. § 242.200(a).

g. Pending Long Sale Documentation Requirements Under Regulation SHO

The Commission currently has pending proposed amendments to Regulation SHO, which would require broker-dealers, with respect to all sales marked long, to document the present location of the securities being sold.[23] As the Commission is aware, SIFMA had strongly opposed such proposal, in that it would involve significant and costly systems programming changes, and could actually result in unintended negative consequences, including harming customers by hindering execution quality and market liquidity. SIFMA is therefore hopeful that the Commission has decided to not proceed further with the proposed long sale documentation requirements, choosing instead to pursue proposed Rule 10b-21 and the proposed amended Prime Broker Letter, as alternatives. (Comment: Without "long sale" documentation abusive SIFMA members and abusive DTCC participants will obviously cheat on "ownership" issues. In the short sale of hard to borrow securities the expense of a borrow or the unavailability of a borrow makes it tempting to intentionally mislabel a "short sale" as a "long sale" to avoid expensive or unavailable borrows or "locates". What is wrong with forcing the seller of shares in a "long" capacity to disclose where the shares (that may or may not land by T+3) are located? Why is there all of this concern to protect the clearly abusive members of SIFMA and the DTCC that intentionally mislabel trades for monetary reasons involving circumventing expensive borrows? Why would a legitimate "owner" of securities labeling his sale as "long" have a problem with disclosing its location?)

h. "Long" Sales of Rehypothecated Securities

SIFMA notes that the Commission definitively stated in the Proposing Release that:
"a seller would not be making a representation at the time it submits an order to sell a security that it can or intends to deliver securities on the date delivery is due if the seller submits an order to sell securities that are held in a margin account but the broker-dealer has loaned out the shares pursuant to the margin agreement. Under such circumstances, it would be reasonable for the seller to expect that the securities will be in the broker-dealer's physical possession or control by settlement date."[24] (Comment: This makes perfect sense since the "seller' has no clue if his shares have been "hypothecated" (loaned out without a delivery being involved or "promised out") elsewhere.)

This positive statement by the SEC appears to resolve uncertainties that have existed since the inception of Regulation SHO concerning whether, under a strict reading of the rule, it is permissible for a broker-dealer to mark as "long" a sale by a customer of securities which have been rehypothecated, (Comment: That's not the same thing as being rehypothecated out of a margin account where the right to rehypothecate has been signed off on.)even where delivery by the broker-dealer technically may be consummated with borrowed shares. In such case, these transactions do not, in fact, meet the definition of "short sale" in Rule 200(a) because the delivered securities are neither borrowed by the customer, nor borrowed for the account of the customer.[25] Instead, they are borrowed by the broker-dealer, for its own account, and appear as a "borrow" obligation of the broker-dealer on the firm's books and records (*i.e.*, the broker-dealer, and not the customer, has the obligation to return the securities and bears the market risk). To be sure, a broker-dealer's rehypothecation of customers' margin securities in this manner does not at all affect the customer's long position with respect to those securities – *i.e.*, the customer is still "deemed to own" the securities (Comment: If the margin account holder wants to sell securities that have been "rehypothecated" elsewhere then quite obviously the b/d should make a borrow elsewhere so that T+3 delivery can be made to the new purchaser. The "hypothecation" process does not provide an opportunity for the creation of "packages of rights" out of thin air. A "long" position in an account does not equate to "ownership" as defined by 200(b) of Reg SHO. "Long" positions are easy to create during abusive naked short selling frauds; "ownership" positions are tougher.)

within the meaning of Rule 200(b), (Comment: No, in a margin account with no "fully paid for shares" the customer never did "own" the securities. The b/d that loaned him the money retains "ownership" because Cede and Co., the nominee of the DTCC, legally "owns" these shares FBO the b/d hosting the margin account) and his or her account statements continue to show any rehypothecated margin securities as long positions. So as to avoid any doubt, SIFMA requests that the Commission confirm this view in the Adopting Release.

IV. Conclusion

In summary, SIFMA strongly supports the Commission's efforts to address potentially abusive naked short selling, and likewise appreciates that the proposed Rule properly shifts responsibility for such potentially abusive activity away from broker-dealers, and towards a party who is providing false information to the broker-dealer. (Comment: Abusive naked short sellers work in tandem with "enablers" of these crimes. They can't do it on their own. They need a network of "enabling" market intermediaries like order entry b/ds, prime brokers and clearing firms willing to be intentionally "deceived" in order to intentionally reroute the funds of overly trusting investors into their own wallets and into the wallets of these willing co-conspirators.)As noted above, rather than adopting a new anti-fraud rule, SIFMA believes that these policy goals can be best accomplished by implementing the pending amendments to the Prime Broker Letter, and through the Commission's existing authority to address manipulative trading activity under Section 10(b), and Rule 10b-5 thereunder. Should the Commission decide to proceed with 10b-21 however, SIFMA would respectfully request that the Commission consider the important points noted above, and adopt an amended version of the Rule.

If you have any questions or require additional information, please do not hesitate to contact the undersigned at 202-434-8400 or Amal Aly, SIFMA Vice President and Associate General Counsel, at (212) 313-1268. Thank you for your attention to this request.

Sincerely,

Ira D. Hammerman
SIFMA Managing Director and
General Counsel

cc: The Hon. Christopher Cox, Chairman
The Hon. Paul Atkins, Commissioner
The Hon. Kathleen Casey, Commissioner
Dr. Erik Sirri, Director, Division of Trading and Markets
Robert L.D. Colby, Deputy Director, Division of Trading and Markets
James A. Brigagliano, Associate Director, Division of Trading and Markets
Josephine Tao, Assistant Director, Division of Trading and Markets
Victoria Crane, Branch Chief, Division of Trading and Markets
Kevin J. Campion, Sidley Austin LLP

THE MANAGED FUNDS ASSOCIATION LETTER

Re: Proposed Naked Short Selling Antifraud Rule; S7-08-08

Dear Ms. Morris:

Managed Funds Association ("MFA")[1] appreciates the opportunity to comment on the Securities and Exchange Commission's ("SEC" or "Commission") proposed naked short selling antifraud rule (the "Proposed Rule") under the Securities Exchange Act of 1934 (the "Exchange Act"), issued in Release No. 34-57511 (the "Release").

I. Introduction

MFA fully supports the Commission's efforts to combat naked short selling and other market abuses. Market manipulation, such as intentional and abusive naked short selling, undermines the integrity of the U.S. capital markets and threatens investor confidence, market liquidity and market efficiency. MFA commends the Commission for its work in adopting Regulation SHO to address the problems of naked short selling and extended fails to deliver. Regulation SHO has simplified and streamlined the procedures for all short sellers to locate securities for borrowing (Comment: Perhaps but the "locate requirements" within Reg SHO introduced 4 glaring loopholes begging to be abused. They include:

1) Allowing order executing b/ds to execute short sales by merely having something as subjective as "reasonable grounds" to believe that delivery would occur by settlement date.
2) Allowing "customer assurances" from the short sellers themselves i.e. "away locates" to qualify as being "reasonable grounds" to believe that delivery would occur by settlement date provided that the b/d has a "reasonable basis" for believing the "customer assurance". Subjective terms like these are predestined to massive abuses.
3) Allowing the mere presence of securities on easy to manipulate and unregulated
e "easy to borrow" lists to qualify as being "reasonable grounds" to believe that
d delivery would occur by settlement date.
4) Allowing brokers to enter into poorly defined "bona fide arrangements to borrow"
s securities to qualify as a "pre-borrow".

Abusive hedge funds should indeed be very appreciative for this "streamlining" of "locate" requirements. In reality the very predictable abusing of these glaring loopholes is what necessitated the proposed Rule 10b-21. The net effect was the allowance of yet a couple of more years of rampant abuses to occur due to the lack of **specificity**. Criminal aspects of civil law needs to be very, very specific just like it is in criminal law.

and significantly reduced the average daily number of fails to deliver.[2] (Comment: Note the citation of the same Office of Economic Analysis statistics that were easily discredited by academics. In the SIFMA "comment letter" it was cited as footnote #5. Note the tendency of both lobbying/trade groups to cite deeply-flawed statistics. The DTCC's contention that less than 1% transactions result in an FTD while refusing to remove non-equity transactions that can't fail in delivery, not citing that CNS "netting" removes 96% of transactions from having the ability to technically "fail" is typical and not addressing FTDs held in ex-clearing arrangements is disingenuous at best.) We believe the locate requirement has also had a strong impact discouraging naked short selling. (Comment: Just the opposite; its subjective wording has invited abuses as proven by the need for Rule 10b-21.) MFA also supports the Commission's efforts to prosecute fraud. We are concerned, however, that the Proposed Rule may have the unintended consequence of deterring legitimate short selling (Comment: Only if the referred to "legitimate short selling" regularly employs **"Industry practices"** involving the "intentional deceit" of the market intermediaries or purchasers of that being short sold; which in turn wouldn't make it very "legitimate" even though it may be the status quo on Wall Street. "Legitimate" short selling, by definition, does not involve deceit, FTDs and scienter. Nobody that makes a legitimate borrow before short sales will be "deterred" in the least.)
MFA regards short selling as an essential method by which investors, including fiduciaries managing others' assets, can manage risk, hedge their portfolios, and reflect their view that the

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[1] MFA is the voice of the global alternative investment industry. Our members include professionals in hedge funds, funds of funds and managed futures funds. Established in 1991, MFA is the primary source of information for policymakers and the media and the leading advocate for sound business practices and industry growth. MFA members represent the vast majority of the largest hedge fund groups in the world who manage a substantial portion of the approximately $2 trillion invested in absolute return strategies. (Comment: When victimized investors write "comment letters" to the SEC they state their case and sign their names individually. Why would individual hedge funds that "manage a substantial portion of the

approximately $2 trillion invested in absolute return strategies" prefer to hide behind the moniker of one "of the vast majority of hedge fund groups in the world who manage…..? If as a hedge fund you stand behind the iterations being presented then proudly sign your name. Is it because when you perpetrate a fraud as obvious as refusing to deliver that which you sell then operating in the dark is preferable?)

MFA is headquartered in Washington, D.C., with an office in New York.

[2] Fails to Deliver Pre- and Post-Regulation SHO, Office of Economic Analysis, SEC (Aug. 21, 2006) *available at* http://www.sec.gov/spotlight/failstodeliver082106.pdf (providing that the average daily aggregate fails to deliver declined by 34% after the effective date of Regulation SHO).

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current market price of a security is higher than it should be. (Comment: There is a difference between that valid concept and being able to easily manipulate downwards the share price to any level you desire. The difference involves deceit, FTDs and scienter.) The benefits of short selling to the broader market are well known.[3] Short selling provides liquidity to the market and makes markets more efficient. (Comment: No argument there but again legitimate "short selling" does not involve "intentional deceit" upon market intermediaries or the purchasers of short sold securities. This is the topic being discussed here; namely whether to deem this behavior as being "unlawful" or "fraudulent" or not. "Legitimate" short selling is indeed a wonderful thing but that's not the topic of discussion here.)

We believe that the Proposed Rule, as constructed, is unnecessary and overbroad. The impetus for the proposal is the Commission's concern with abusive naked short selling, which involves an intentional failure to deliver securities within the standard settlement timeframe. As noted by leading scholars from academia and industry at the SEC's Roundtable on the Regulation SHO Pilot,[4] however, there is no persuasive evidence that short selling in general is more frequently abusive than other types of transactions. (Comment: So what possible harm is there in deeming "intentional deceit" upon market intermediaries and purchasers during the course of short sales as being unlawful? The evidence of pandemic levels of ANSS and DFRAs is readily available via FOIA analyses and SEC Chairman Cox is on the record as stating that Reg SHO was inadequate in addressing these crimes because it had no "teeth" which is why Rule 10b-21 was proposed in the first place and approved for "comment" solicitation on 3/4/08.) Indeed, manipulative purchases—for example, so-called pump-and-dump schemes, appear to be far more common than abusive short sales. (Comment: Absolutely incorrect as abusive naked short selling occurs nonstop all day long in the markets of typically defenseless development stage issuers.) Historically, there have been far more market manipulation enforcement cases against pump-and-dump boiler room operations than short sellers. (Comment: this is true and consistent with the thesis that the SEC and SROs have been "captured" by the interests of those that they are supposed to be regulating.) Thus, we question the need to single out naked short selling from other transaction types. (Comment: The victimized authors of the thousands of comment letters condemning this practice over the last several years would beg to differ. Why would the addressing of any "single" type of crime like abusive naked short selling bother your organization enough to compel you to submit this comment letter? Except for those with a financial interest in allowing naked short selling frauds to thrive who in the world would "question the need to single out naked short selling from other transaction types"? Shouldn't all forms of criminal behavior be firmly dealt with? Again, as mentioned at the outset you can learn a lot about market participants via public "comment letters" when those content with the corrupt status quo are given the unenviable task of making their case to keep the corrupt status quo. At one point in time legislators "singled out" the crimes of bank robberies and murders also; perhaps every crime has its day to be "singled out" via "highlighting the liability" for perpetrating these frauds.)

The Release states that the purpose of the Proposed Rule is to highlight the specific liability of persons that deceive specified persons about their intention or ability to deliver securities in time for settlement. We question the necessity of the Proposed Rule, since the Commission acknowledges that it already has ample authority to prosecute persons who engage in abusive naked short selling and fraudulent misrepresentations in connection with sales of securities. Rather than adopting an entirely new rule that will raise a host of interpretive issues (some of which are discussed below), the Commission can highlight the liability of persons who engage in deception in connection with securities sales by issuing a notice or statement of policy that it will pursue such cases under its existing antifraud authority, including Section 17(a) of the Securities Act of 1933, and Sections 10(b) and 15(c) of the Exchange Act and rules 10b-5 and 15c1-2 thereunder. (Comment: True but merely "issuing a notice or statement of policy that it will pursue such cases under its existing antifraud authority" has not provided enough meaningful deterrence to these crimes. History has taught us this and now the SEC sees the need to provide more "meaningful" deterrence to gain the attention of those continuing to perpetrate these "frauds on the market".)

The Release cites no data to support the need for this rule, and cites only three cases over a 29 year span. (Comment: The purpose of the release was not to list out all of the cases prosecuted to date.) We do not believe that this record supports the adoption of the Proposed Rule. In light of the comprehensive set of short sale regulations the Commission has implemented, additional operational procedures implemented by broker-dealers (Comment: Why is the hedge fund industry so concerned about the "operational procedures" that the b/ds must implement? Is it because the brokerage industry is needed by the hedge funds to "enable" these frauds?) to achieve compliance with Regulation SHO, and broad antifraud authority under existing statutes and rules, we believe the Commission should instead focus on the enforcement of existing regulations to prosecute naked short selling. (Comment: At the SEC open meeting the point was made that new "operational procedures" would be de minimis as Reg SHO already mandated the various procedures and surveillance mechanisms to be put into place.)

Nevertheless, if the Commission deems it appropriate and necessary to promulgate a naked short selling antifraud rule, we urge the Commission to carefully consider the potential unintended

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[3] *See*, e.g., Arturo Bris, William N. Goetzmann and Ning Zhu, "Efficiency and the Bear: Short Sales and Markets Around the World" (Yale School of Management, Jan. 2003), a study of forty-seven stock markets around the world, in which the authors found that markets with active short sellers reacted to information more quickly and set prices more accurately; and Owen A. Lamont, "Go Down Fighting: Short Sellers vs. Firms", available at http://www.som.yale.edu/faculty/oa14/research/go%20down%20fighting.pdf (concluding that constraints on short selling as a result of various actions taken by firms allow stocks to be overpriced and that firms taking anti-shorting actions have in subsequent year abnormally low returns of about minus two percent per month).

[4] SEC Roundtable on the Regulation SHO Pilot (Sept. 15, 2006) *webcast at* www.connectlive.com/events/secshoroundtable/.

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consequences of the Proposed Rule. Short selling plays a significant economic function in our markets and counterbalances pressures that cause a stock to be overpriced. We hope the Commission will recognize the benefits of short selling in a final rule release and assure market participants that a naked short selling antifraud rule is not meant to deter legitimate short selling. (Comment: Again, why all of the concern for deterring "legitimate" short selling **UNLESS** the current "industry practice" for legitimate short selling involves deceit, FTDs and scienter?)

II. Comments

A. Unintended Consequences

MFA commends the Commission for the short sale regulatory approach taken in Regulation SHO and believes the Commission achieved the right balance between guarding against short selling abuses and regulating in a manner that would not impede liquidity and the ability of market participants to establish short positions. As a result, the number of failures to deliver on an average day is exceptionally low—less than 1% of the dollar amount of total daily trading.[5] MFA is concerned, however, that the Proposed Rule would have the unintended consequence of reversing some of Regulation SHO's achievements by deterring legitimate short selling, impeding liquidity, and negatively impacting best execution. (Comment: If deeming unlawful the intentional deception of market intermediaries and purchasers is going to "impede liquidity" then does this not confirm the existing levels of intentional deception being tolerated? The need for scienter protects an individual from liability from inadvertent FTDs not due to any fault of his or her own. Recall the words of former Chairman Donaldson: "How much fraud should we put up with in the name of liquidity. The answer is zero.")
The Release states that scienter would be a necessary element for a violation of Rule 10b-21. The Release also indicates that the Commission would follow the views of the federal appellate courts that have concluded that scienter may be established by a showing of knowing conduct or by "an extreme departure from the standards of ordinary care" (the latter is often referred to as "recklessness"). **(Comment: In my mind this is exactly why Rule 10b-21's specific listing out of all behaviors associated with ANSS and DFRAs deemed to be unlawful is so critical. As it stands now these abuses are so pandemic that the "standards of ordinary care" might be construed as everybody else is committing these frauds so why can't I. My 28 years of research in this field tells me that the problem is related to a regulatory vacuum wherein the SEC assumes that the SROs are monitoring for these abuses and the SROs hold the opinion that if things really are out of control in this realm then the SEC would do something about it and until they do then the "status quo" is just fine, thank you very much.**

The process of making "locates" and "pre-borrows" before short sales has gotten very "sloppy". The hedge funds put in short sales to their "Order Entry Broker-Dealers" or "OEBDs". If the "OEBDs" can't find a "locate' or a "pre-borrow" they're not going to admit it to the hedge funds they depend on to direct them order flow. They're going to fail delivery and allow the DTCC rules and regulations to nurture and hide that FTD from the investing public's eyes. Either that or they'll go to a co-conspiring firm that they know would be more than happy to provide them with a "DL" or "deceitful locate" in exchange for some future "back scratch". If they get "busted" by the "securities cops" they can always say that they "assumed" that the hedge fund's prime broker had taken care of the "locate" or "pre-borrow" since this is "industry practice" or that they assumed that their co-conspiring firm was telling the truth. If they get called on the carpet they'll explain it as a clerical error, say OOPS and claim that it won't happen again. After a while some clever DTCC participants recognized the regulatory vacuum they were operating in and said to themselves nobody's monitoring the sloppiness of our "locates" and "borrows" so why even bother faking them. If we get busted we just play the OOPS card and have the prime broker and OEBD point an accusing finger at each other and claim that they thought the other party took care of the "locate" or "pre-borrow". That's the least they can do on behalf of the hedge fund feeding them all of this order flow. The reality is that every market intermediary on Wall Street is heavily financially incentivised to generate and hide FTDs.

The "sloppiness" in this arena is matched by an equal amount of "sloppiness" in Reg SHO. Point #1 is that "borrows" for "hard to borrow" shares are either expensive or unavailable. Point #2 is that these expensive or unavailable "borrows" can be circumvented by a "DL" or "deceitful locate" or a "DB" "deceitful borrow". The natural market deterrent to these

crimes involving less shares being available to borrow and thus a higher cost of borrowing is eliminated. All you currently need now is to have "reasonable grounds" to think that a "locate" will result in T+3 delivery to avoid these expenses. This is insane when you have the ability for OEBDs and prime brokers to both claim that the other party took care of the "locate" should the securities cops show up at your door. Even more insane is to allow "customer assurances" to provide "reasonable grounds". The abusive naked short selling hedge fund utters to his OEBD I "assure" you that I already took care of the "locate" so go ahead and process the short sale order. Of course people are going to cheat when the OOPS card can be played. Specifically listing out activities in this arena deemed to be unlawful is critical. Also it is critical to designate a "score keeper" tallying up what percentage of "locates" performed by b/d "X" resulted in FTDs and what percentage of "locates" received by b/d "Y" resulted in FTDs. After studying how easy it is for hedge funds to access these loopholes one starts wondering why all hedge funds that engage in short selling don't play these games especially with "hard to borrow" securities. One must keep in mind that the typical targeted corporation in these crimes is the relatively defenseless development stage company with these "hard to borrow" securities.)

Recklessness is a much more subjective standard and we are concerned that honest mistakes could be re-characterized as reckless conduct with the benefit of 20/20 hindsight. As a result, a recklessness standard for liability could have an unwarranted and counterproductive chilling effect on short selling.

In particular, we are concerned that a person who fails to deliver a security on or before the date delivery is due as a result of an operational shortcoming could be alleged to have been reckless in representing that she had a good locate or was long the security, even where there was no intent to deceive anyone. There are many instances where such failures to deliver may arise. For example:

Scenario 1: A seller obtains a locate for a "hard to borrow" security, but the source is unable to deliver securities at settlement.

Scenario 2: A seller experiences a systems malfunction which results in a failure to locate or an inaccurate locate, unbeknownst to the seller.

In each instance, even if the seller could argue that she did not intentionally deceive any of the persons covered by the Proposed Rule, the seller might be subject to claims that the seller was reckless because she did not exercise sufficient care before making her representations in

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[5] SEC Open Meeting discussing Proposed Naked Short Selling Antifraud Rule (Mar. 4, 2008) *webcast at* www.connectlive.com/events/secopenmeetings/.

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connection with the sale.[6] The fear that operational failures could potentially subject sellers to antifraud allegations would have a negative impact on short selling. (Comment: I wonder if this "red herring" is mercury free or not.) The Proposed Rule also could impede liquidity if broker-dealers tighten their securities lending standards out of a concern about increased legal liability (discussed further below). 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. (Comment: Reg SHO already mandated these changes nearly four years ago.)

We believe that a narrowly tailored rule requiring a finding of intentional deception will best achieve the Commission's objective without deterring legitimate short selling. Requiring a finding of specific intent, rather than recklessness, is particularly appropriate given that the Commission's ultimate goal in proposing Rule 10b-21 is to prevent market manipulation. The anti-manipulation provisions of Section 9 of the Act generally require a showing of specific intent.[7] (Comment: Section 9 deals with the "Manipulation of security prices" while this Section 10 being addressed here deals with "Manipulative and deceptive devices". The problem is that "intent" can easily be obfuscated by abusive hedge funds working through OEBDs that in turn must work with prime brokers. If the OEBDs were the prime brokers then more accountability would be present. The more intermediaries you line up in "daisy chain" fashion the tougher "intent" is to prove because of the availability of the OOPS card. I think a history of this kind of behavior as easily detected by the trading data addresses "intent" quite effectively.) MFA recommends that a finding of knowing conduct and not recklessness be required for a violation of a naked short selling antifraud rule.

B. Private Right of Action

Although the Release is silent on the matter, at the March 4, 2008 Commission open meeting, Commission staff stated that there would be a private right of action under the Proposed Rule. (Comment: Historically this is typical of Section 10 cases.)We are concerned that a private right of action under the Proposed Rule would subject sellers to frivolous, unwarranted, and expensive litigation, and could further deter legitimate short selling. This is particularly the case if recklessness, as discussed above, could serve as a basis for a private right of action for violation of the rule.

There is a great deal of public confusion and misunderstanding about failures to deliver. As noted by the Commission and its staff, failures to deliver can arise from a variety of causes, many of which are not problematic.[8] (Comment: Since over 95% of shares are held in "street name" at the DTCC and the overwhelming majority of legitimate delays in delivery failures are associated with paper-certificated shares then this use of the "many FTDs are legitimate" card is getting a little overplayed.)Nevertheless, we are concerned that members of the public often incorrectly presume that unlawful conduct has taken place whenever there is a failure to deliver securities and may bring lawsuits (including strike suits) under the Proposed Rule on that basis. (Comment: The ability of a purchaser of securities to detect that her purchases weren't delivered is basically nil due to how the DTCC operates. CNS "netting" also hides the identity of the account that failed to deliver. Not many corporations are going to take on Wall Street behemoths with frivolous lawsuits especially after PSLRA was enacted in 1995.)

The United States has become an increasingly litigious society and a private right of action under the Proposed Rule would further open the door to more litigation and raise the costs of doing business. Such a right would provide another avenue for issuers whose securities have been heavily shorted to retaliate against short sellers.[9] (Comment: But the subject being dealt with is the intentional use of deceit with scienter not legitimate short selling.) Broker-dealers would also be subject to further

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[6] We appreciate the guidance in the Release about the use of "Easy to Borrow" lists in connection with short sales, and about long sales from a margin account where the broker-dealer has loaned out the shares. (Comment: Translation: Thanks again for the loopholes.)However, these examples illustrate the numerous interpretive questions that the Proposed Rule raises.

[7] *See, e.g.*, Crane Co. v. Westinghouse Air Brake Co., 419 F.2d 787 (1969, CA2 NY), *and* In Chris-Craft Industries, Inc. v. Piper Aircraft Corp., 480 F.2d 341 (1973, CA2 NY).

[8] SEC Release 34-50103 (July 28, 2004), 69 Fed. Reg. 48008, 48016 n.85 (adopting Regulation SHO); *Division of Market Regulation: Key Points About Regulation SHO,* Section II (Apr. 11, 2005) (providing the example that human or mechanical errors or processing delays can result from transferring securities in physical certificate rather than book-entry form, thus causing a failure to deliver on a long sale within the normal three-day settlement period).

[9] Cf. Release at n.30 and accompanying text

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litigation as many plaintiffs see broker-dealers as deep pocket defendants. (Comment:

the question that might arise is how much of that "deep-pocketedness" might be attributable to past abusive naked short selling (ANSS) frauds.) The consequence is that short sellers and broker-dealers would be subject to greater legal liability, which in turn would deter legitimate short selling. (Comment: not if they're not routinely using "intentional deceit" with scienter as part of their short selling activities. By your own admission only 3 meaningful cases have been brought forward in this arena over the last gazillion years.)

The concern of broker-dealers will be heightened by the statement in the Release that "as with any rule, broker-dealers could be liable for aiding and abetting a customer's fraud under the proposed rule." (Comment: This is why the order entry b/ds (OEBDs) or "executing brokers" should take their mandate/responsibility to determine "reasonable grounds" that delivery will occur by settlement date seriously instead of as a joke. After all, they are participants of an SRO mandated to regulate the "business conduct" of its participants namely the DTCC.) It is well settled that private plaintiffs may not bring charges based on aiding and abetting liability under Section 10(b) or the rules thereunder,[10] (Comment: On the contrary; the point that aiding and abetting liability under Section 10(b) of the '34 Exchange Act has been clearly established according to testimony by SEC counsel at the SEC Rule 10b-21 "open meeting".) so this statement may be confusing in the context of the Commission staff's statement that a private right of action would be available for violations of Rule 10b-21.[11] Even if this statement is clarified to limit it to Commission actions for aiding and abetting, the Release provides no guidance as to what kinds of activity would be viewed by the Commission as aiding and abetting a customer's fraud. (Comment: A valid point and the text of 10b-21 should specifically spell out examples of aiding and abetting in ANSS crimes involved with deceit i.e. intentionally providing "DLs" and "DBs".)This uncertainty may cause broker-dealers to reduce their securities lending activity in connection with short sales or require unnecessary documentation from customers about their locates and long positions, all to the detriment of market efficiency. (Comment: In markets where ANSS and DFRA abuses are pandemic the documentation from customers about their locates and long positions does not inhibit "market efficiency". On the contrary it creates "pricing efficiency" so that abusive naked short sellers can't merely execute deceitful locates and deceitful borrows in an effort to flood a targeted corporation's share structure with incredibly damaging "securities entitlements" that predictably manipulate share prices downwards. Remember the whole issue being addressed here is declaring intentionally deceitful activity associated with locates, borrows and ownership issues as being unlawful i.e. fraudulent. Conventional wisdom might hold that most people that don't incorporate these activities into their standard methodologies for establishing short positions probably wouldn't have a problem with that.)

We believe the Commission's enforcement authority is sufficient to address any wrongdoing covered by the Proposed Rule, and that the costs of a private right of action would outweigh the benefits of such a right. We accordingly recommend the Commission adopt a narrowly tailored antifraud rule without a private right of action.

C. Customer Locate Representations

As noted in the Release's fourth Request for Comment, the adopting release for Regulation SHO specifically allows a broker-dealer to satisfy the locate requirement by obtaining an appropriate assurance from its customer, provided that the broker-dealer has a reasonable basis for believing the customer's assurance. (Comment: This along with the abuse of the bona fide MM exemption from locates and pre-borrows are the two most commonly utilized modus operandi utilized for these thefts. Due to the fact that the DTCC's "CNS netting" process has a tendency to obfuscate the account through which ANSS activities are occurring a mere "Customer Assurance" from an abusive hedge fund or market participant is next to worthless. Abusive hedge funds will proactively seek out abusive OEBDs and prime brokers willing to act upon bogus "Customer assurances", "deceitful locates" and "deceitful borrows" in exchange for lucrative order flow and prime brokerage business. That's just how the system is wired. You don't bite the hand that feeds you.) The Release nevertheless asks whether the Commission should no longer permit a broker-dealer to rely on a customer's assurances. (Comment: When the "ultimate paradox" is available to exploit then mere "customer assurances", the presence on easy to borrow lists, having "reasonable grounds", etc. are unconscionable because of the negligible risk to reward ratio.)

The ability for a broker-dealer to rely on customer representations about locates is critical to the markets and should not be eliminated or undermined. Virtually all sophisticated investment management firms obtain custody and clearing services separately from trade execution services by entering into prime brokerage arrangements. These arrangements allow the investment manager to obtain best execution for its clients by using many different executing brokers and electronic trading systems, while settling and clearing transactions into a relatively small number of prime brokerage accounts. Securities lending is one of the primary services offered by the prime brokers. So, in a typical short sale, the investment manager first obtains a locate from one of its prime brokers and then executes the short sale with one of many, competing executing brokers. In this situation, the executing broker must rely on the investment manager's assurance regarding the locate, because systems do not currently exist through which the prime broker can automatically or quickly confirm the locate directly to the executing broker. (Comment: On the contrary the Omgeo system which is a collaboration between Thomson Financial and the DTCC provides that service. Reg SHO already mandates the documentation of the "locate. Again, this is not rocket science! How do you argue against a rule that declares it "unlawful/fraudulent" to steal investor funds through the use of deceit, FTDs and scienter and keep a straight face? How tough would it be for a prime broker to communicate with an OEBD in writing that the "locate" is legitimate? Why trade off the speed of execution versus investor protection and market integrity?) If the SEC were to prohibit the executing broker from relying on the investment manager's assurance regarding the locate, it would effectively require the investment manager to execute the trade only with the

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[10] *Central Bank of Denver v. First Interstate Bank of Denver,*

511 U.S. 164 (1994).

[11] This statement in the Release suggests to us that the Commission did not intend that a private right of action would be available.

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prime broker that provided the locate, thereby eliminating the valuable competition among executing brokers that promotes best execution. (Comment: Good idea; let's trade off investor protection for that all important "competition among executing brokers that promotes best execution"! Remember that many of these hedge funds are unregulated in the first place and based offshore in locations subject to strict banking secrecy laws which makes them more likely to push the legal envelope.)

Further, many sophisticated investment managers have created their own securities lending capabilities, enabling them to borrow securities directly from large custodians. These capabilities can reduce costs for the investment manager's clients and improve access to hard-to-borrow securities, which are often not available from prime brokers. If executing brokers were prohibited from relying on the investment manager's assurances regarding the locate from these sources, transaction costs would increase and investment opportunities for the investment manager's clients would be reduced. (Comment: It is true that short selling "investment opportunities for the investment manager's clients would be reduced" if the investment manager couldn't find a legitimate "locate" or "pre-borrow". That's the natural market deterrent to abusive naked short selling frauds. Maybe, just maybe the reason for the inavailability of "locates" or "pre-borrows" is that other short sellers have already exhausted the supply.)

For these reasons, changing the current rules to prohibit a broker-dealer from relying on its customer's assurances to satisfy the locate requirement would increase the costs and reduce the quality of execution for institutional investment managers and their clients and reduce overall liquidity and efficiency in the markets. Therefore, MFA recommends that the Commission continue to permit a broker-dealer to rely on customer assurances in satisfying Regulation SHO's locate requirement. (Comment: If the "customers" were a disinterested 3rd party then that argument might hold water. In the case of hedge funds, OEBDs and prime brokers the concept is insane. The obvious solution for all of these arguments is to have a "scorekeeper" tally the percentages of "customer assurances" that still result in FTDs and punish the guilty parties that chronically abuse "customer assurances". What has to be kept in mind is the billions of dollars of savings available to those trying to bypass expensive pre-borrows in the hard to borrow securities typically targeted in naked short selling attacks.)

D. Scope

The Proposed Rule's target is deception in connection with a sale of securities that results in a failure to deliver on settlement date. We believe that the rule can and should be narrowed to reflect the Commission's concerns and achieve the Commission's goals. The text of the Proposed Rule applies its prohibition to all sales of securities, whether short, naked short, or long. However, the release focuses on two instances of deception by sellers: fraudulent misrepresentation about a locate and fraudulent misrepresentation about a "long" position. A locate must be done before a short sale, and a fraudulent misrepresentation about a long position (to avoid the need for a locate) means that the sale is actually a short sale. Accordingly, if the rule were limited to fraudulent misrepresentations about short sales, both of these contexts would be covered. (Comment: Except for the fact that this would open an argument that fraudsters could later make that 10b-21 only addresses "short sales" and my client was technically involved in a "long sale".)

Moreover, although the Proposed Rule is crafted largely as an adjunct to Regulation SHO and its locate requirement, the rule as proposed would apply more widely. The locate requirement of Regulation SHO applies only to sales of equity securities, but the rule as proposed applies to sales of all securities. This may in fact be a drafting matter, because the Release states that "Proposed Rule 10b-21 would apply to sales in all equity securities."[12]

As there is no record to support the application of this rule to other types of securities, MFA recommends that the Commission clarify that the rule applies only to short sales of equity securities.

E. Direct Market Access Systems

The Release requests comment on the application of the Proposed Rule to the use of direct market access systems ("DMAs") and electronic communications networks ("ECNs"). (Comment: Note that within a "Direct Market Access" (DMA) system or "Sponsored Access System" (SAS) a seller can "pigtail" in sell orders through a usually larger b/d with "direct access" to market centers. Again you have that "one step removed" phenomenon similar to hedge funds, OEBDs and prime brokers wherein the "sponsor" firm can claim that it had no idea that the party "pigtailing" sell orders in didn't perform a proper "locate". We "assumed" it did since it is "industry practice" to do so and we therefore had "reasonable grounds" to think that it had performed a locate. Abusive naked short sellers would obviously gravitate towards a DMA willing to play dumb on obviously bogus "locates" in exchange for order flow. Luckily the SEC had enough foresight to structure 10b-21 stating that if you deceive your "sponsor" involved in a DMA relationship then this is to be deemed unlawful. But like an abusive OEBD seeking hedge fund orders what are the chances that an abusive DMA sponsor will squeal on his clients that direct him order flow. “Electronic Communication Networks” or “ECNs” have long been utilized by abusive naked short sellers for usually two reasons. First they were not subject to the old “Uptick rule” for “technical reasons” and secondly they provide anonymity so important to the commission of a crime as obvious as refusing to deliver that which you sell.) We do not believe that the Proposed Rule would create any problems in connection with DMAs or ECNs. (Comment: Translation: Let’s keep these massive loopholes intact, thank you very much.)

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[12] 73 Fed. Reg. at 15380.

In this regard, however, it is important that the SEC not impose, without providing an opportunity for public comment, any specific requirements regarding the form or substance of any data that must be communicated through the DMA or ECN at the time of the trade to evidence the customer's locate. (Comment: Translation: Whatever you do don’t make us document locates associated with DMAs and ECNs! Why in the world would the SEC treat these venues any different than any other venues? I mentioned at the outset that you can learn a lot from “comment letters”. Of course the same documentation rules should cover all routes into a market center.)The flexibility allowed to broker-dealers in satisfying their documentation obligation in Rule 203(b)(1)(iii) of Regulation SHO should be preserved. (Comment: As DMAs and ECNs are ripe for ANSS and DFRA abuses due to their designs and limitations it’s interesting that the hedge fund community petitions that no changes be made to these “without providing an opportunity for public comment” i.e. a 2 year stalling period.)

III. Conclusion

MFA appreciates the opportunity to share its views on the Proposed Rule. We would be pleased to meet with the Commission and its staff to further discuss our comments. Please do not hesitate to contact me at 202-367-1140, if we can be of further assistance.

Sincerely,

Richard H. Baker President and Chief Executive Officer

CC: The Hon. Christopher Cox, Chairman The Hon. Paul S. Atkins, Commissioner The Hon. Kathleen L. Casey, Commissioner Dr. Erik Sirri, Director

Division of Trading and Markets Mr. James Brigagliano, Associate Director Division of Trading and Markets

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DISCUSSION

Wow; where to start? One can readily see that both comment letters made the exact same arguments and even the phraseology was identical in parts. Since they landed at the SEC within one day of the other then it becomes extremely obvious that the brokerage community and the hedge fund community are joined at the hip in fighting any clamping down on naked short selling abuses. This should obviously be no surprise as the brokerage industry is needed to “enable” these crimes.

The underlying theme of both comment letters is to leave open all current loopholes and don’t add any new laws that might interrupt the currently corrupt status quo. Why not interrupt the currently corrupt status quo? Well because “liquidity” might be affected and there might be “unintended consequences” associated with assuming short positions. Besides, who’s going to keep in check those “pump and dumpers”? When you overlay Mark Mitchell’s treatise on deepcapture.com onto these findings you end up with massive amounts of organized crime elements in ANSS and DFRA types of crimes. You can see the role of the corrupt financial media, the hedge fund industry, the brokerage industry, the role of the Internet bashers, etc. In other words we have one gargantuan mess to deal with. Where does the mom and pop investor that wants to dedicate a small percentage of his or her investment portfolio into development stage corporations fit into this? Where does the SEC fit into all of this? The DOJ?

REVIEW

First of all one has to appreciate the critical mass represented by the combination of the brokerage community on Wall Street plus the hedge fund industry which accounts for over half of the trading volume in our markets. These are very powerful groups making these comments. I told you earlier that these "comment letters" have a tendency to reveal insights you can't find anywhere else? What did they say? What were they implying? Here's a summary plus some implications:

SIFMA

1) Technically naked short selling isn't even defined (Implication: so it can't be too much of an issue because all noteworthy crimes have a formal legal definition otherwise they're tough to prosecute effectively. Dear SEC: Let's formally define it via 10b-21!)
2) We think you should focus responsibility on those providing the bogus information (i.e. those nasty hedge funds that have **deceived** us into processing naked short sale orders that we had no idea were illegal.)
3) "Overall Reg SHO appears to be having its intended effects" (So no more laws please! Then why did Chairman Cox at the open meeting on Rule 10b-21 state that it turned out that Reg SHO had no "teeth" and thus we need to augment its effects with this new legislation.)
4) There is "a steadily-declining level of fails-to-deliver, as well as a declining number of Threshold Securities" (Then why Dr. Erik Sirri the Director of the Division of Trading and Markets state at the Rule 10b-21 open meeting that FTDs have not gotten any better. It's been such a smashing success that a corporation just celebrated its 800th day on the list.)
5) "The National Securities Clearing Corporation ("NSCC") [indicates] that 99% (by dollar value) of all trades settle on time". (The qualifier missing here is that the delivery status of 96% of all transactions is obfuscated by the nature of the CNS "netting" process and equity transactions were lumped in with other transactions that rarely fail. The FTDs in ex-clearing were also not tabulated.)
6) "Market makers must sell a security to a buyer even when there are temporary shortages of that security available in the market." (The antithesis of this is that MMs (including those that belong to SIFMA) must buy back these same securities that they were "forced" to sell when sell orders started to dominate over buy orders and the PPS dropped.)
7) "SIFMA does not believe that enactment of a new anti-fraud rule that might have unintended consequences is the most efficient means available to the Commission to achieve its goals." (We've got enough rules already.)
8) Allowing "customer assurances" to provide "reasonable grounds" that the borrowed shares will land by settlement date is a wonderful idea. (Sure, especially when the "customers" are unregulated and operating from offshore or Canada where their securities regulators find no problem whatsoever with the naked short selling of U.S. domiciled development stage corporations.)

9) "SIFMA believes that Section 10(b) of the Exchange Act and Rule 10b-5 thereunder already provide the Commission with ample authority to address manipulative or fraudulent trading activity." (No new laws "highlighting the liability" of those perpetrating certain behaviors as being deemed unlawful are necessary especially if aiding and abetting crimes come into play as well as private rights of action.)
10) "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." (Please don't do away with this gigantic loophole; an unregulated hedge fund perhaps out of the reach of the SEC and DOJ would never fib about the source of a "locate" to save a fortune in lending fees.)
11) "Furthermore, a prohibition on away locates would be severely detrimental to small executing brokers that may not have comparable access to a large stock loan supply." (Let's not tighten up the laws because small b/ds would be at a disadvantage.)
12) "Moreover, creating a new anti-fraud rule specifically targeted at naked short selling may create uncertainty and confusion". (Anarchy will result!)
13) "SIFMA notes, in this regard, that Congress has not provided any express cause of action for private citizens to sue for civil damages for violation of proposed Rule 10b-21." (Whatever you do don't let the victims of this thievery sue us.)
14) "Proposed Rule 10b-21 specifically applies to sellers, who are best postured to know their own obligations and ensure compliance therewith. While SIFMA recognizes that broker-dealers cannot turn a blind eye to illegal activities by their customers, broker-dealers should not be held responsible for policing their customers' compliance with their own legal requirements." (Yeah, Dear SEC: Let's let secrecy-obsessed hedge funds based in the Cayman Islands that are the "sellers" regulate themselves. Let's let them provide "investor protection and market integrity" on your behalf.)
15) "Furthermore, because proposed Rule 10b-21 contains as a key element the fact that the seller deceive the broker-dealer, it is unclear in what situations a broker-dealer would know of, and aid and abet a violation." (How about if the last 20 times this seller sourced his own "locate" 90% of the trades resulted in FTDs? The necessity for the visibility of FTDs all throughout the system is of paramount importance especially for prospective investors in a corporation with so many unaddressed FTDs within its share structure that it may be preordained to die an early death regardless of its merits.)
16) "SIFMA is concerned that the extension of proposed Rule 10b-21 to "purchasers" may subject broker-dealers to meritless civil litigations that would impose tremendous costs to defend. The end result could be a chilling effect on legitimate short selling". (Imagine that, a purchaser of shares in which the seller refused to deliver that which he purchased having a cause of action. (More anarchy!)
17) "We appreciate the guidance in the Release about the use of "Easy to Borrow" lists in connection with short sales." (Thanks for the gaping loophole since no regulator is monitoring for the integrity of "easy to borrow" lists.)

THE HEDGE FUNDS (MFA)

18) "Regulation SHO has simplified and streamlined the procedures for all short sellers to "locate" securities for borrowing." (Thanks for the 4 aforementioned gigantic loopholes left in the Reg SHO "locate" requirements.)
19) "We believe the locate requirement has also had a strong impact discouraging naked short selling." (Don't you dare get rid of those massive loopholes contained within the locate requirements.)
20) "We are concerned, however, that the Proposed Rule may have the unintended consequence of deterring legitimate short selling". (If the hedge fund community deems that deceit, FTDs and scienter are all a part of "legitimate" short selling then deterring this would be an "intended" consequence not an "unintended" consequence.)
21) ""MFA members represent the vast majority of the largest hedge fund groups in the world who manage a substantial portion of the approximately $2 trillion invested in absolute return strategies." (Then we can assume that nearly the entire hedge fund community is behind these recommendations and assertions.)
22) "As noted by leading scholars from academia and industry at the SEC's Roundtable on the Regulation SHO Pilot, however, there is no persuasive evidence that short selling in general is more frequently abusive than other types of transactions." (There's all kinds of crime out there why focus in on our little fiefdom? Why don't you focus your efforts on lemonade stand robberies where the big money is being lost?)
23) "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." (If you don't allow us to commit our crimes then who's going to keep in check those other criminals.)
24) "The ability for a broker-dealer to rely on customer representations about locates is critical to the markets and should not be eliminated or undermined." (After all, what could be more trustworthy than an offshore unregulated hedge fund out of the reach of the SEC trying desperately to circumvent expensive or unavailable borrows?)
25) "The Release requests comment on the application of the Proposed Rule to the use of direct market access systems ("DMAs") and electronic communications networks ("ECNs"). We do not believe that the Proposed Rule would create any problems in connection with DMAs or ECNs." (Don't you dare mess with these 2 gigantic loopholes either!)

SUMMARY REVIEW

When you recognize the combined critical mass of the brokerage and hedge fund industries being represented by these "comment letters" you can't help but find this tap dancing around our securities laws reprehensible but not all that surprising. For crying out loud the issue here is whether or not to deem behavior that includes **<u>all three</u>** of deceit, FTDs and scienter as being "fraudulent" and therefore "unlawful". Dear SEC, first of all we'd like to thank you for loopholes # 1-12. Those are swell! As far as new laws don't you think our law books are thick enough? As far as being held accountable for our fraudulent activity you seem to be forgetting that we are Wall Street and that accountability and Wall Street are not allowed to be contained in the same sentence. What you at the SEC must concentrate on is **<u>"liquidity</u>**". Buyers of shares need liquidity and the more the merrier. In fact, drowning development stage corporations in this “liquidity” is a good thing because they were probably scammy anyways and provide fertile fields for the “pump and dumpers”. You just can’t get enough of a good thing like liquidity.

ANCILLARY TASKS NEEDING TO BE PERFORMED TO AUGMENT THE EFFECTIVENESS OF 10B-21 AND REG SHO

1) The foundational premise for these crimes, the “Ultimate paradox”, needs to be removed. Sellers of securities that absolutely <u>**refuse**</u> to deliver that which they sell cannot be allowed to access the funds of the defrauded investor. Merely collateralizing an “open position” does not constitute the “good form” delivery necessitated for these trades to legally “settle”. This is the engraved invitation to commit fraud that underlies this entire family of securities frauds (ANSS and DFRAs) and it has resulted in the declaration of an “open season” for fraudsters worldwide to attack the relatively defenseless U.S.-domiciled development stage corporations. (I’ve often thought that the term <u>**“refuse to deliver”**</u> (RTD) should be used for an FTD older than T+13 because the conscious decision to go yet another day without delivering that which you sold an inordinate amount of time ago has to be made on a daily basis and not just on T+3. There is only one cure for an “RTD” and that is a <u>forced</u> buy-in not by a fellow DTCC participant that might face retaliatory measures but by an uncompromised regulatory authority.)
2) Divide your efforts up into two separate approaches. Firstly deal with preexisting naked short positions that are currently poisoning the share structures of target issuers. The goal would be no more unwarranted corporate deaths or investor losses related to issuers already under attack. The second approach would be to never allow this to occur again in our clearance and settlement system.
3) You need to get back to basics. The mandate of the DTCC is as per Section 17 A “to promptly and accurately clear and <u>**settle**</u> all transactions”. <u>**“Prompt settlement”**</u> mandates the prompt “good form” delivery of that which was advertised for sale and thought to be being purchased i.e. legitimate “shares”. You were on the right track in the proposed version of Reg SHO which necessitated the <u>**“withholding of the mark”**</u> until delivery was accomplished. This means that the DTCC participant account of the seller did not get credited the buyer’s funds <u>**until**</u> delivery occurred i.e. until the transaction <u>“settled</u>”. The DTCC talked you out of that stance by telling you that “collateralizing” the debt “is just as good as withholding the mark”. You got hoodwinked by billionaire behemoths able to collateralize massive debts with what amounts to be pocket change to them and able to force share prices of targeted issuers and therefore their own collateralization requirements into a death spiral! “Prompt settlement” is “Prompt settlement”. “Settlement” is defined as “the <u>conclusion</u> of a transaction involving the delivery of that purchased in exchange for payment or “delivery versus payment”. Now go to the DTCC website and publications and read about “trades that have <u>settled</u> but not <u>concluded</u> yet”. These trades aren’t legally “settling”. Go back again to the DTCC website and read how 99% of all trades “settle” on time. No they don’t; they get collateralized on time or hidden in ex-clearing on time. The DTCC is not a “Clearance and settlement” system; it has morphed into a “Clearance and collateralize” system and boy don’t the fraudsters know it!

4) FTDs held and hidden in ex-clearing **<u>"arrangements"</u>** (pseudo-contracts entered into to circumvent "good form" delivery and therefore the "settlement" of trades) need to be quantified, added to the number of FTDs held and hidden at the DTCC and elsewhere and then made available to prospective investors prior to their pulling the trigger on a trade. If deceit, an FTD and scienter is needed to qualify as unlawful/fraudulent behavior then <u>all</u> FTDs need to be made visible to the authorities and tallied whether they are housed at the DTCC, in an ex-clearing format, held at trading desks, held offshore, hidden via repurchase agreements, flex options, synthetic long positions, option MM hedging, etc.
5) FTDs are much more numerous than currently reported. Why? Because of the concept of "good form" delivery. That which is being "delivered" in exchange for payment must be legitimate "shares" with its "package of rights" intact. The "delivery" of mere IOUs or "securities entitlements" from self-replenishing lending pools like the DTCC's "Automated Stock Borrow Program" (SBP) does not constitute "good form" delivery. Notice how the comment letters reviewed asked that you not change their access to the SBP and to count FTDs as CNS-related fails only and not the much larger number of actual FTDs.
6) The irrefutable proof of these frauds is right in front of you at the SEC in the form of the trading data. Truly bona fide MMs cover preexisting naked short positions on the first downtick below the level at which they assumed a naked short position. Those that refuse to do this are <u>illegally</u> or <u>fraudulently</u> accessing the exemption from making a locate or pre-borrow before making admittedly naked short sales. They are aware of and in search of the "Ultimate paradox" i.e. the ability to access an investor's funds without delivering that which he or she purchased. SROs, regulators and the DOJ truly interested in putting an end to this crime wave do not have that tough of a task in front of them. There are no "Confidentiality" issues associated with "Proprietary trading methodologies" that might be compromised when the <u>authorities</u> study the trading data. This layer of "darkness" serving to obfuscate these crimes is gone in the case of robust regulatory investigative and enforcement activities. The question is and always has been are you with the authority to address these crimes up to the task of getting organized, rolling up your sleeves and doing the right thing before yet more U.S. corporations and the investments made therein become worthless?
7) The formal definition of "Abusive Naked Short Selling" (ANSS) needs to be adopted similar to the formal definitions of every other form of crime. How can you effectively deal with a crime that does not have a formal legal definition? The lack of a formal definition is contributory to the lack of success in deterring and later prosecuting these crimes.
8) The SEC has to quit citing grossly misleading studies like the one wherein the NSCC claims that only 1% of transactions fail to "settle" and the vast majority of those are cleaned up shortly thereafter. "Collateralization" of debts does not constitute the "settlement" of a trade. Review what Dr. Leslie Boni found when given a flashlight and permission to go behind the scenes at the DTCC. Your citation of this study in footnote #9 of your 10b-21 release allowed both SIFMA and the MFA to cite these grossly flawed studies while making their arguments for the maintenance of the status quo. Even the studies of your own "Office of Economic Analysis" (OEA) regarding delivery failures are flawed.
9) A venue needs to be set up wherein an allegedly victimized issuer can present information to those in authority that if corroborated could lead to the authorities studying the pertinent trading data while maintaining confidentiality and not releasing any bona fide "proprietary trading methodologies". Remember, refusing to deliver that which you sell is not a bona fide "proprietary trading methodology" deserving confidentiality. It is a form of fraud and it is unlawful. Allegedly victimized issuers

would risk investigations into their own corporations if the circumstances indicated it appropriate. This "self-screening" would result in the truly victimized issuers approaching the SEC for help while those corporations claiming abusive naked short selling attacks to obfuscate their own malfeasance would refuse this scrutiny. Shareholders of companies refusing this scrutiny could then be granted some indirect transparency.

10) This measure would narrow down the universe of securities needing to be considered as being victimized. Once the diagnosis of abuse is confirmed then measures need to be taken to remove the excessive numbers of mere "securities entitlements" out of the share structure being poisoned.
11) The predictable mass migration of FTDs from the DTCC to ex-clearing hiding places subsequent to Reg SHO becoming effective has made the "threshold lists" totally ineffective. There is no such thing as a T+13 day mandated buy-in with all of the current loopholes available for "parking" FTDs across the street for extended amounts of time via "wash sales", repurchase agreements, flex options, etc. Recall the Evans, Geczy, Musto and Reed (2004) study indicating that only 0.12% of even "mandated" buy-ins on Wall Street are ever done.
12) "Easy to borrow" lists need to be closely monitored if the presence of an issuer's shares on one are allowed to constitute "reasonable grounds" to believe that shares sold in a transaction will be delivered by T+3. The only stipulation now is that they must be less than 24 hours old. One can only imagine the abuses involved in this loophole.
13) Statistics needing to be kept:
    - A) What percentage of a b/d's transactions involving the citing of "easy to borrow" lists result in FTDs.
    - B) What percentage of the "away locates" related to "customer assurances" given by a b/d result in FTDs.
    - C) What percentage of the "away locates" received by a b/d result in FTDs.
    - D) What percentage of short sales involving "reasonable grounds" and "bona fide arrangements to borrow" result in FTDs.
    - E) The percentage differential of buys versus sells of a given MM for trades in a given issuer labeled as "Short sale exempt" or "SSE". (In the case of a truly bona fide MM they would be fairly equal. In the case of an issuer whose PPS is dropping there is absolutely no reason why a bona fide MM wouldn't be buying back that which he sold)
    - F) The percentage of buys versus sells in the last 10 minutes of trading versus throughout the rest of the day. ("Painting the tape" downwards at the end of the day)
    - G) What percentage of transactions entering via DMAs result in FTDs.
    - H) What percentage of transactions entering through ECNS result in FTDs.
    - I) What percentage of transactions coming through Canadian b/ds result in FTDs.
14) The SEC must make a clarifying statement that they don't interpret UCC Article 8 as <u>forcing</u> market intermediaries to treat all purchasers of shares as "owners" of those shares. (Many perpetrators of these frauds claim that UCC 8 "forces" them to treat all purchasers as "owners" of shares. Some shareholders of an issuer own legitimate "shares" of an issuer while other shareholders own mere "securities entitlements". We don't know which shareholders own which because all shares are anonymously pooled at the DTCC. There is no statutory authority for the DTCC to create "unsubstitutible" rights like voting rights out of thin air.
15) Mandate the public disclosure of the FTDs associated with "ex-clearing arrangements".
16) The single most effective method to address these abuses is to <u>force</u> theoretically bona fide MMs that access the exemption from locates and pre-borrows by labeling short sale

orders as “SSE” or “Short sale exempt” (exempt from the borrow or locate) to simultaneously place and leave open a bid for the same amount of shares being naked short sold at perhaps 2% below the level at which the naked short sale occurred. MMs need to prove their bona fide status by being forced to do exactly what a truly bona fide MM would do before gaining access to the exemption. Any MM having a problem with that concept would obviously not be acting as a truly bona fide MM that provides **both** buy-side and sell-side liquidity when order imbalances occur.

I thank you once again for this opportunity to contribute suggestions to remedy these abuses.

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