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MEMBER OF THE NEW YORK STOCK EXCHANGE

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Ms. Florence E. Harmon
Acting Secretary
Securities and Exchange Commission
100 F. Street, N.E.
Washington, DC 20549-1090

Re: Release No. 34-58773; File No. S7-30-08
Amendments to Regulation SHO
Interim Final Temporary Rule 204T

Lek Securities Corporation ("LSC") respectfully submits these comments upon Interim Final Temporary Rule 204T (the "Rule"), File No. S7-30-08, which seeks to extend certain restrictions on "naked" short selling that were enacted as emergency measures in July 2008. As set forth below, the Rule has not proven effective and should not be extended.

The Rule has been in effect for a sufficient amount of time to evaluate its effectiveness. In the almost six months it has been in effect, the Rule has done nothing to halt the decline in equity values or curtail market volatility. The Rule ignores market realities that make compliance difficult, if not impossible, because of potentially unlimited losses to both firms and customers. Most fatally, the Rule has impaired the stock loan market, an important source of necessary liquidity, to the detriment of the industry as a whole.

LSC is a broker dealer primarily engaged in executing and clearing Equity and Options trades for professional and institutional customers. Our firm is a member of all of the major exchanges in the United States. We are also members of the Depository Trust and Clearing Corporation, The Options Clearing Corporation and the Canadian Depository Services.

The Rule Does Not Advance Its Stated Purpose.

We understand that the Commission has been under political pressure to appear to be doing its part to resolve the current financial crisis. The Rule has been justified by "excessive fluctuations

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of securities prices and [the] disruption in the functioning of the securities markets that could threaten fair and orderly markets" which, the Commission suggests, may be caused by "unfounded rumors regarding the stability of financial institutions by short sellers … to increase profits through 'naked' short selling." The danger of so-called "'naked' short selling" is over-stated, if not entirely fictional, as demonstrated by the fact that the Rule has done nothing to stem market volatility or market declines since its initial enactment in July. The Rule doesn't work because it doesn't address the real causes of the problems with the economy. Market volatility and market declines have been caused by liquidity problems, uncertainties regarding corporate earnings, and an economy in a deep recession, not by the newly-minted bogeymen of "naked" short sellers. The Rule does nothing to address the root causes of the market volatility and market declines, but instead (as show below) actually exacerbates these causes by decreasing liquidity in the markets.

<u>The Rule Increases Market Volatility and Uncertainty by Decreasing Necessary Market Liquidity.</u>

The Commission should be concerned about the Rule's many unwarranted side effects. The most serious consequence of the Rule is that it has sharply curtailed the stock loan market, as eloquently explained by Peter Kovac, Chief Operating Officer and Financial and Operations Principal, EWT, LLC and by Jennifer S. Choi, Assistant General Counsel, Investment Adviser Association.

The stock loan market is essential to the good health of the securities markets. The stock loan market is a means by which brokerage firms can finance their positions. It is a credit market, and in the current environment, the Commission should follow the example of the Federal Reserve and seek to add credit and liquidity to the system. Instead the Rule has done the opposite. Brokerage firms use the stock loan market to lend out their securities. In return they received cash from the borrower. This was an important source of financing. With the stock loan market vastly curtailed, brokerage firms have become more reliant on the banking industry for financing, exactly at the time that banks are less willing to lend. The Rule can also lead to unnecessary borrowings. This in turn consumes limited credit facilities and requires firms to post cash collateral, which drains liquidity from the industry. These phenomena should be a grave concern to the Commission. It was well publicized that the Bear Stearns failure was not due to lack of capital, but due to a lack of liquidity and being shut out from the credit markets. Increasing the securities' industry dependence on the banking industry is undesirable, unless one believes that the brokerage industry as we have known for many years should cease to exist and that the securities business should be exclusively conducted by broker dealer subsidiaries of large banks.

Stock loans were also used to facilitate deliveries, which reduced outstanding fails. Assume the following example: A firm has a customer who has bought 120,000 shares of XYZ and sold 100,000 shares of the same stock. The customer maintains an account with a custodian bank. On the settlement date, the firm will receive 20,000 shares of XYZ from CNS, representing the net quantity purchased. The firm would typically borrow 100,000 shares of XYZ in order to be able to make the required delivery to the custodian bank. Without the stock loan market, however, the firm cannot borrow the shares and thus cannot make the delivery. The custodian bank cannot deliver to the firm, because the bank needs the firm's delivery to be in the position to do this. The result is a deadlock. Although the deadlock might be resolved by a pair off, that resolution requires several days to arrange. In the meantime, the firm must finance the 20,000 shares that it is long, which is costly and ties up valuable liquidity.

<u>Regular Market Forces Are Sufficient to Protect Against Non-Delivery.</u>

The Commission should leave the resolution of fail-to-delivers to the SROs and the DTCC, who have effectively dealt with the problem for years by means of the buy-in process. A buy-in allows a purchaser who does not receive delivery on the settlement date, after a two day notice period, to buy the securities in the open market and close out the contract with the original seller. Any resulting loss is automatically charged to the party that failed to deliver. The threat of a buy-in was a natural, market driven deterrent for anyone to not make proper delivery on the settlement date.

Buy-ins were typically done for "cash" or T+1 settlement. They also were arranged to settle "broker-to-broker". In other words, the trade would be arranged to settle, "ex-clearing', i.e. not through the clearing house. This way the broker conducting the buy-in would know exactly who the seller was and expect guaranteed delivery through DTCC and thereby completely avoid the anonymity of the CNS system. Buy-ins were an effective means of closing out a fail-to-deliver. They could be costly to a failing seller and therefore made "naked" short selling virtually non-existent.

However, due to Reg. NMS, it has become much more difficult to arrange special trades, such as ex-clearing and T+1 trades, because the trading venues, where special trades can be negotiated in person, such as the floor of the NYSE and the NASDAQ "phone" market have become significantly less prevalent. As a result, in today's markets many buy-ins are done through electronic trading systems that clear through CNS. Consequently, when a buy-in is conducted, one fail-to-deliver from the clearing house is likely to be replaced with a new fail-to-deliver from the clearing house. This has made the buy-in process significantly less effective. The best solution for so-called "persistent fails to deliver" is to reinstitute the market for ex-clearing (non CNS) trades for guaranteed delivery.

<u>The Rule has substantial deleterious unintended side effects other than impairing liquidity</u>.
In addition to impairing liquidity, the Rule raises substantial technical concerns:

- If a firm closes out a customer sell at a loss for the customer and the customer maintains an account with a custodian bank, how does the Commission envision that the brokerage firm will be compensated for the loss? The custodian bank is likely to DK an SPO charge. Does the Commission expect the brokerage firm to pay the loss from its own capital and take legal action against the customer, which can take years and cost millions?

- How should a firm treat the receipt of securities from a customer that has both long and short sales on one particular settlement date when the receipt satisfies some, but not the entire amount that the customer is required to deliver? Did the customer deliver the long sale of the short sale?

- What does the Commission expect firms to do if the security has been "chilled" at DTCC?

- Why does the Commission insist that positions are covered, before the opening of the market? Although pre-opening markets exist, trading large volume before the opening is likely to increase volatility. This runs exactly contrary to the Commission's stated objective.

- As other commentators have suggested, the Commission must allow for a *de minimus* exemption. It is simply not possible to borrow very small amounts of stock. The cost of delivering and returning the stock, daily mark-to-market, and the calculation of the interest charge make stock loans economically infeasible if the amount is smaller than $1 million.

- What if a customer is assigned on a short put option position which is part of a hedged portfolio. Should the short position be closed out, which will remove the hedge and leave the customer exposed to unlimited loss?

Conclusion

The Rule has not worked to advance its stated purpose. On the contrary, the Rule has impaired market liquidity and caused other problems that are harmful to the good health and orderly operation of our financial markets. The Rule creates other substantial problems for both firms and customers, without any offsetting benefit or justification. For these reasons, we respectfully submit, the Commission should take the following action:

- The Commission should rescind the Rule, effective immediately; and
- The Commission should focus its attention on providing liquidity to the industry; and
- The Commission should work with the exchanges and DTCC to restore a viable buy-in market, which will be effective in eliminating all "naked" short selling.

Respectfully submitted,

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