

# Thomas Vallarino

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

**RE : Amendments to REG SHO's Market Maker Exemption**  
**Release No. 34-56213; File No. S7-19-07**

**October 22, 2007**

Ladies and Gentlemen:

I would like to add a significant clarification and solution to the issue of short selling and delivery failures of securities in a way that has not been discussed by the SEC nor any of the SIFMA members before.

Specifically, all securities must be properly defined. This is a very basic step, but one which is not taking place in the securities markets in this country, despite laws requiring this. So when addressing short sales and delivery failures of securities, it is important to be clear what securities are being referred to, as there are two types of securities involved in the securities markets today that are distinctly different from each other. However, these two different securities are never properly distinguished, but interchanged and mentioned in the same breath as if they were the same security. But they are not. Both types of securities must be clearly defined so that money is not debited from investor accounts for securities they had no intention of buying.

## **Broker/DTCC Securities**

These securities are mostly held in street name on deposit at the DTCC and owned directly by the brokers and not by investors, regardless of what their accounts say. These securities, issued by the corporations, are properly registered with SEC, as required of all securities traded publicly.

However, investors do not own nor control any of these securities, as only brokers have accounts at the DTCC in their name. Investors do not.

Securities on deposit at the DTCC are not credited to investor accounts.

### **Investor/Broker Securities (Securities Entitlements)**

The securities credited to investor accounts are also called “securities entitlements” by the SEC and SIFMA members. These are different securities from those on deposit at the DTCC. It is in exchange for the securities credited by brokers to investors, that money is debited from investor accounts.

It is important to distinguish securities entitlements from the real registered securities on deposit at the DTCC in the name of the brokers. It is also important to point out that these securities credited to investor accounts, lack a registration statement and so lack any definition. So they mean whatever the brokers want them to mean and also mean different things at different times with the same brokers. This is possible, precisely because there is no registration statement nor sufficient disclosure to investors about the nature of these securities. So brokers are free to assign whatever package of rights to these securities as they see fit.

However, per the Securities Acts, the securities credited to investors by brokers require a registration statement and not only per the Securities Acts, but also per SEC rules, as these are defined as securities even by the SEC. Investor/Client contracts and other disclosures do not give full information to investors, and Erik R. Sirri, Director of the Division of Market Regulation, SEC stated as much in a speech just a few days ago on October 16,2007. And even if they did, it wouldn't satisfy the legal requirement to file a registration statement.

*"When an imbalance occurs between the number of securities on deposit at the broker's DTC account and the number of securities credited on its customer accounts, the brokers can do one of a couple things."*

*"The methods by which brokers allocate votes to their specific customers also vary significantly."*

Further SEC rule 405 defines securities as:

#### *Definitions*

**Equity security.** *The term equity security means any stock or similar security, certificate of interest or participation in any profit sharing agreement, preorganization certificate or subscription, transferable share, voting trust certificate or certificate of deposit for an equity security, limited partnership interest, interest in a joint venture, or certificate of interest in a business trust; any security future on any such security; or any security convertible, with or without consideration into such a security, or carrying any warrant or right to subscribe to or purchase such a security; or any such warrant or right; or any put, call, straddle, or other option or privilege of buying such a security from or selling such a security to another without being bound to do so.*

The Securities Act of 1993 defines a security in almost the exact same way in section 5. So we have the legal definition and the admittance of the Director of Market Regulation of the SEC admitting that “securities entitlements” credited to investor accounts are indeed securities. Yet where is their registration statement? What do these securities mean? What rights do they confer? Investors certainly don’t know because brokers aren’t disclosing this and certainly the answer changes from one broker to another and can vary depending on when the question is asked.

This is exactly why rule SEC 405 and Section 5 of the 1993 Securities act define these as securities and as such require these securities to file a registration statement so that investors and the market know what they are buying with the money being debited from their accounts.

Only after this oversight is rectified, and Securities Entitlements file a registration statement, can the SEC even begin to get a grip around the harm done to markets and investors by having investor money debited for something other than what they think they are buying.

For what difference does it make if all open delivery failure positions of registered securities were closed out and prohibited, if brokers can continue to define securities credited to investor accounts any way they like? If securities entitlements can mean anything, then money can be debited from investor accounts without the broker obtaining the registered security in like numbers. This circumvents protecting investors by stopping delivery failures.

While SEC rule 15c3-3 would limit this to some degree, this rule is so liberal, that a large percentage of securities credited to investors could still mean just about anything.

So I suggest the SEC enforce compliance with the Securities Acts and its own rules by mandating a registration statement for all securities entitlements credited to investor accounts, so that investors know exactly what their money is being debited for from their accounts.

Otherwise, brokers will simply continue to credit securities to investors with fewer rights than they really confer, thus misrepresenting the securities being credited and the market for registered securities and create false appearances.

So without addressing registration statements and definitions of securities credited to investor accounts, REG SHO can will not stop investors from being harmed and the distortions in the market of excessive sell side liquidity and interests.

Alternatively, instead of requiring a registration statement for securities entitlements, the SEC could promulgate a blanket rule that defines all securities entitlements credited to investor accounts as being defined to represent one unencumbered, existing registered security. Any of these two solutions would end the confusion and loopholes and the practice of debiting money from investor accounts for misrepresented securities.

Sincerely submitted,

Thomas Vallarino