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 31, 2007

Ladies and Gentlemen:

The Naked silver scandal involving Morgan Stanley is indicative of the issue at hand with naked short selling of securities, REG SHO and the elimination of the market maker exemption.

The silver fraud, which is an analogy to the securities fraud by Wall Street firms against investors, involves crediting non existent silver to investor accounts. Here, it was found in court that Morgan Stanley gave false balances for Silver to investor accounts and even charged for Silver storage, for Silver Morgan Stanley never had and had never even bothered to buy in the first place.

Thus points to the credibility and willingness of these large firms to defraud their own clients and the markets. So I ask that the SEC take this into consideration when reading and speaking with representatives of these firms.

This also points out that inter broker FTDs, as REG SHO exclusively addresses, is not enough to stop FTDs against investors. Since these naked short sales to investors are never captured via REG SHO and the threshold list, another mechanism must be added to monitor and ensure compliance with the Securities Acts.

Again I quote your Director of Market Regulation that made this statement on October 16,2007.

> "*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.*"

This is exactly why these "security entitlements" securities should file a registration statement, so that investors and the markets know what they are buying with the money being debited from their accounts and know at all times what is really held on their behalf. Not only is this common sense, it is required by the Securities Acts. SEC rule 405 and Section 5 of the 1933 Securities Act clearly define securities entitlements as securities. So the SEC needs to force compliance with the existing statutes, and defining securities, which are fundamental principals of any securities market.

Only when securities entitlements file a registration statement and get properly defined, can the SEC even begin to get a grip on the harm done to markets and investors by broker/dealers. Investors should not be kept in the dark about the nature and number of securities in their accounts.

And it is not enough to just focus on what is credited to accounts. When securities are debited for lending purposes, this too must be clearly disclosed and visible to the investors who have paid money for the securities. At the very least, investors have a right to know what is being done with their property and even what type of property they are buying in the first place.

Otherwise, brokers will simply continue misrepresenting investor accounts about the securities being credited and maintained for investors and continue to create false appearances of trades in registered securities, violating section 9 of the 1934 Act and Section 5 of the 1933 Act.

Theodore Butler wrote various articles on the Silver Fraud, from which I have selected quotes to summarize the issue :

> *On September 24, a Federal Judge in New York heard final oral arguments in the class-action settlement between Morgan Stanley and 22,000 of their clients involving costs associated with the storage of precious metals. The parties have agreed to settlement terms. Morgan Stanley will pay several million dollars and promises to revise their precious metals storage processes*
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> *The issue specifically concerns whether Morgan Stanley and many other large financial organizations who claim to hold and store silver for their customers, actually possess the silver.*
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> *…….there are two types of silver when it comes to professional storage, real silver and paper silver; cold hard metal versus imaginary or make-believe silver. I claimed that investors could be making a mistake in assuming that the metal held for them actually existed. I warned that free storage was a certain tip-off that no real metal existed, but even the payment of storage charges did not prove that real*

metal existed.

Most stored silver is in 1000-ounce bars, and they are always identified with serial numbers and a specific weight. If an investor was concerned, all he or she had to do was request the serial numbers and specific weights of the bars they owned.

A reader, who held silver in 1000 oz bars, requested Morgan Stanley provide him with the serial numbers and weights of his bars, on which he had paid storage and insurance fees for many years. He was given the run-around and not the serial numbers and weights. I am aware of this through e-mail exchanges with him. I told him that the only plausible reason they wouldn't give him the information was because the bars did not exist. He contacted a lawyer and that ultimately resulted in the class-action settlement, after years of legal wrangling.

By not actually buying and storing the real metal to back the customers' purchase, financial firms can greatly enhance their bottom line profits through the free use of the customers' funds. Morgan Stanley's actions were not in any way unique in this practice. In fact, in the court documents summarizing the proposed settlement, one of Morgan Stanley's defenses was that they were not doing anything unusual by charging storage on metal that didn't exist, as this is a widespread industry practice.

On a purely financial basis, the institution is given cash by the client and does not have to return it until the client sells his silver, which may not be for years or decades. For the entire time the client does not sell, the firm has full use of his money on a zero cost of funds basis. Those firms who charged, and still charge, storage and insurance fees for the non-existent silver rake in even more from the client. Honest dealings aside, this is a very cash-flow positive business for these institutions. Even if silver doubles or triples in price, there is no margin call to the selling institution, as clients don't issue margin calls. As long as clients don't sell on a net basis, the issuing institution still doesn't experience negative cash flow. In our short-term world, that is all that matters. If you or I arranged to do what hundreds of world financial institutions have done, we would quickly be put in jail, as it is fraud, pure and simple.

I prefer to deal in documented facts and figures, and not to

guess what the total amount might be, but there are no reporting requirements or clearinghouse data available. Were it not for the class-action settlement involving Morgan Stanley, I'm sure many would deny this situation existed at all. Fortunately, because of this case, no one can deny the practice of unbacked silver certificates exists.

Had the actual silver been purchased, as it should have been, when the clients deposited funds to pay for the metal, that would have been reflected in the price. In addition to deceiving the client, they short-circuited the normal supply and demand function of the free market. This was an unfair restraint of trade and the free market. To those who would say this is no big deal, ask yourself this – would you knowingly do business with a stock or bond broker who never actually bought what you instructed them to buy, but just treated your investment as a bookie and bet you were wrong? Would securities and banking regulators look the other way?

This is a short position, pure and simple. The firms and banks that have sold silver to clients without immediately going out and buying the real silver that the clients paid for are short the metal. That means the issuers are liable and responsible for any price rise in silver over the price to the client. For small and medium sized firms, this is a huge risk.

This is a short position separate and distinct from the short positions on the COMEX or from forward selling/leasing. This puts the combined short position for silver in the billions of ounces. To suggest this unbacked short position is somehow hedged (just as some contend, the forward selling/leasing position is somehow hedged) is nonsense. The documented commercial long position on the COMEX is so small that it couldn't cover even one medium-sized issuer of unbacked silver certificates.

It is important to remember that this incredibly large, additional short position unique to silver has the same price effects that all large short positions have in any item. First, comes the artificial price-depressing impact it has when it is created, then comes the artificial price-enhancing effect when it is eventually closed out. What that means to investors is this – the price-depressing phase of short sales of unbacked silver storage programs is behind us. This is one more reason why silver is still so cheap.

This is exactly what happens in the securities market, when brokers credit unbacked certificates of deposit for securities into investor accounts.

Step by step these abuses must be eliminated and the next step must the elimination of the market maker exemption in REG SHO.

The next step must be the enforcement of the Securities Acts by requiring the registration of these deposit securities or securities entitlements as the SEC likes to call them that are credited into investor accounts – the only securities investors directly own.

Sincerely Submitted,

Thomas Vallarino