REGHELL.COM™
38 COUNTY ROAD 645
SANDYSTON, NJ 07826
DGSERENA@REGHELL.COM
973-362-1252

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Ms. Nancy M. Morris
Secretary
Security and Exchange Commission
100 F. Street N.E.
Washington, D.C. 20549-1090

Comments on Proposed Amendments to Regulation SHO File No. S7-12-06

Dear Secretary Morris,

I appreciate the opportunity to comment on the proposed amendments to Reg SHO. As the president of a consultancy specializing in financial services compliance, I applaud the Commission in its' effort to revisit regulation's on a regular basis.

While the proposed amendments invites answer to many questions I will only comment on three points.

> Should Option Market Maker's be allowed to role over their short position in the underlying security upon the expiration of a series of options?
>
> Yes. If an OMM is forced to repurchase and then short the underlying security again, it would only serve to artificially inflate volume and create short term volatility in the underlying. The only caveat that I would ask the Commission to include is that the OMM be required to move the short position to another proprietary account, and re-establish the hedge in this new account. The position in the underlying would be moved at the closing mark for the underlying on expiration Friday. This would create a clearly identifiable audit trail.
>
> Should fails that occurred prior to January 3, 2005 be closed out and lose their "grandfather" status?
>
> Yes. I am at a loss as to why the industry should have any fails over a year and one half old. If a security has fails due to the inability to transfer the shares, the Commission should already have taken measures to have these cleaned up. If for some other reason, the Commission should be listing the securities and the reasons why the fails cannot be cleaned, on their web site.

The Commission and other proponents of Reg SHO cling to the notion that the best way to deal with naked short selling is to attack the problem at the front end of a trade with the use of a pre-borrow/locate and the price test.

I have expressed for a period of time that the manner in which to handle this is at the back end or settlement of the transaction. The Commission should require that any broker-dealer that has a fail-to receive on their books that is ten (10) business days past settlement (S+10) should be required to set aside regulatory capital at 100% of the then market value, or the original settlement value of the fail (whichever is greater). On S+11 the requirement should be 110%, S+12 120% and so on. Each broker-dealer that has a fail on their books that is subject to this capital set aside, would also be required to file a report with their Designated Examining Authority each Friday detailing the security, number of shares, original dollar amount of the fail and the amount of capital that is being haircut. Additionally the FOCUS report can be modified to add a separate line where broker-dealers would have to insert their amount of haircut set aside explicitly for these fails.
As there are always reasons for legitimate sale transactions to fail for long period of times (transfer issues, corporate action) the broker-dealer with a legitimate aged fail should be allowed to request an exemption through their DEA, similar to the exemption process for Reg T.

I hope that my input is helpful in your process.

Sincerely Yours,

David G. Serena
President