Nancy M. Morris, Secretary
2006 Securities and Exchange Commission
100 F Street, NE Washington, DC 20549-0609

From: Dr. Paul W. Dent (Concerned Investor)
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To the Securities and Exchange Commisioners:

Dear Sirs,

RE : Amendments to REG SHO Release No.: 34-54154, File No.: S7-12-06

Regulation SHO was introduced to address investor concerns that failures to deliver (FTDs) were masking substantial illegal naked shorting activity, which can be used by some short sellers to deliberately attack certain stocks in an illegal and manipulative way. I would like to first remind all concerned of the intent behind the regulation of short sales according to the Securities Exchange acts of 1933 and 1934 and Treasury Regulations.

Many people are puzzled as to how one can sell something one doesn't own. This leads to short sales in general sometimes being classified as "counterfeiting shares". If this were a correct analogy, short sales could indeed be used to dilute the market in those securities and destroy a share price to any extent desired.

I believe the intent of Congress in 240.15c3–3 (Customer protection—reserves and custody of securities) taken together with Regulation T is to ensure that there is no distortion away from an efficient market.

The two of sets of regulations together are intended to balance the excess sell-side liquidity caused by being permitted to sell shares one does not have (i.e. short sell) with an exactly equal amount of excess buy-side liquidity through being allowed to buy shares with money one does not have (i.e. to buy "on margin" using money borrowed using existing account equity as collateral for the loan). This desired balance is achieved by

(i) Requiring shares to be sold short to first be borrowed from a lender, giving the lender an IOU for those shares, and depositing collateral with the lender to the full market value of those shares. The collateral would normally come from the proceeds of the short sale.

(ii) Specifying that only margin accounts in debit can lend shares and receive IOUs in return, and only to the extent of the margin debit.

If in (ii) the value of securities that can loaned is equal to the margin debit, it ensures that legal short sales can only be effected up to the same monetary value as the shares bought with margin debit, thus exactly balancing the extra buy-side liquidity with extra sell-side liquidity.

Any departure from this balance will cause a departure from an efficient market, and pricing of securities will be distorted.

Unfortunately regulation T and 240.15c3–3 are not being interpreted or enforced in a manner which achieves the intended balance, and it is necessary to review the wording of these and make it absolutely clear what is intended. They may even be wrong!
Ideally, a single set of regulations rather than the combination of two sets of regulations should be used to achieve the desired effect. Confusion arises in jointly interpreting a combination of two sets of regulations as to whether the same term (such as the term “Excess Margin”) means the same thing in two very different documents.

Briefly, serious departures from buy-side/sell-side balance are evident due to brokers interpreting 240.15c3–3 as permission to lend securities from customers’ accounts to short sellers up to 140% in value of the total margin debit. This I believe is a misinterpretation of the 30% margin requirement, which requires the customer to supply 30% of the cost of buying a security while 70% of the cost may be borrowed using the security as collateral. The 140% interpretation is being used to allow brokers to lend out 100% of the shares even though 30% have to be fully paid for. 100% of the whole shareholding is 140% of the 70% that is bought with margin borrowing, but that number should never have been written into the regulations. It is the result of a faulty understanding, and should be changed.
That means securities are being loaned out in excess of the securities bought with borrowed money. Moreover, the regulations are silent on how they should be intended in the case that the total margin debit has been used to

purchase several different securities to the account. For example, if an account has 5% by value of security A and 95% by value of security B, and only 5% margin debit, the broker feels free to (and often does) attribute all of the margin debit to the 5% security and thus may lend out 100% of the shareholding in that security. The broker in fact feels free to apply all of the margin debit to one security one day, and a different security the next, thereby opening the door to manipulative practices. Moreover, the broker is free to set his own margin requirements for different stocks, depending on his perceived risk in those securities. There are many stocks that have 30% margin requirements, others which are set at 50% and others which are 70% or 100%. Nevertheless, despite a customer having a 50% margin requirement on a stock, which means he has to have fully paid for 50% of the stock and only borrowed to buy the other 50%, 240.15c3–3 is still being interpreted as allowing the broker to lend out the entire shareholding. These regulations should be reviewed and amended to ensure that the total outstanding short sales (short interest) in any security can never exceed the amount of that security that has been bought with margin borrowing, and not, as today, 140% of that number or even more. The regulation of securities exchange is not intended to favor the brokers, but to preserve an efficient and orderly market and to protect INVESTORS.

When a short seller sells without first borrowing the stock and then fails to deliver, he is flouting the intention of Congress expressed in the laws and regulations to protect the market for investors, and it simply must not be allowed to go on. Regulation SHO was a very poor attempt, that has clearly failed, to pacify those concerned. It should now be amended to clearly state that no broker shall effect sales of securities that the seller has not provided him with. No excuses such as “They are coming over the mountain” or “The dog ate my certificates” should be accepted. Valuable securities should not be treated in such a sloppy fashion. If the seller can’t get them to the market, he should not be permitted to effect a sale.

There is no reason either to make an exception for Market Makers or to allow options Market Makers to hedge the net difference between their put and call positions by naked shorting. A market maker merely connects a buyer and a seller, and if he elects to maintain a net imbalance, short or long, that is his choice to invest his own money and he should not be allowed any privileges which the retail investor does not enjoy. Allowing options MMs to be naked short a security causes a buy-side sell-side imbalance exactly the same as if a retail investor was allowed to naked short, and that should not be permitted.

Please take the opportunity to stiffen regulation SHO to eliminate the market distortion caused by FTDs by

(a) Requiring mandatory buy-ins to settle a trade on T+13 or earlier at the seller's expense

(b) Eliminating the "grandfather clause" by requiring (a) to apply to all outstanding FTD's with the exception perhaps of stocks on the OTC market, which is riddled with criminal stock scams.

(c) Take the opportunity to review whether the combination of Regulation T and 240.15c3–3 is achieving the desire of preserving an efficient market, and amend them if necessary with clear and unambiguous language and formulas for calculating the amount of a security that can be lent out from a margin account containing multiple securities each with different margin requirements/collateral values and with a given amount of margin debit.

Thank you,

Dr. Paul W. Dent