NCANS

National Coalition Against Naked Shorting - Failing to Deliver Securities

April 19, 2007

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

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

Dear Secretary :

We appreciate the SEC extending the comment period, as empirical evidence mounts supporting the complete elimination of the grandfather clause and the market maker exemption contained in REG SHO. The U.S. Supreme Court decision in the EPA case also clarifies the SEC's statutory obligation to enforce the express prohibition on the sale of unregistered securities. The information and comments in this letter is in addition to those submitted by us previously.

The SEC Must Follow The APA When Formulating Rules

The SEC has not followed the guidelines contained in the Administrative Procedure Act (APA) when formulating and finalizing several rules contained in REG SHO. The clearest example is the grandfather clause. While the APA and the Securities Acts require the SEC to justify any new rules with supporting data, and provide an opportunity for public comment, the SEC has failed to do so for the grandfather clause. No justifying data and no public comment period. The only reason given, which is opinion rather than data, is stated below:

> ***"Regulation SHO's grandfathering provision was adopted because the Commission was concerned about creating volatility through short squeezes"***

Further, the March 2007 NASD letter to the SEC clearly states that the NASD has found the grandfather clause is a cause of persistent delivery failure. So the grandfather clause must be eliminated in its entirety as not only is there no data supporting it, but it is clearly harming the stated goal of REG SHO per the NASD. The only empirical evidence regarding the grandfather clause is the damage it does.

The second example of the SEC not following the APA is the SEC's failure to propose or finalize a rule that permits the sale of unregistered securities - securities (per the 1933 Act's definition of a "security") called "securities entitlements", "FTDs", "FTRs" (among others), as is currently being done.

The third example is where the SEC has failed to finalize rules permitting the use of the trade symbol of legally registered securities, simultaneously, by these aforementioned unregistered securities (thereby permitting the use of one trade symbol for several types of securities).

Again, it is important to understand that "securities entitlements", "FTDs," "FTRs" and the others meet all the definitions of "securities", as defined by the Securities Act of 1933, and their sale and trade are therefore only permitted if they are registered.

Current law and common sense would dictate that if securities entitlements, FTDs and other "placeholder" securities are used in a legal manner, by registering them with the SEC, they would need to trade under their own trade symbol and not under that of a different registered security simultaneously. By correctly identifying the different security type, while awaiting delivery or while being lent out, the owner of the registered security would know and would have the correct security credited to his account, and not a fraudulent, erroneous representation via an unregistered security.

Since the SEC **never** proposed or finalized rules permitting,

1. The sale and trade of unregistered securities
2. The use of the same trade symbol for multiple types of securities
3. The crediting of "securities entitlements" and other placeholder securities in lieu of lawfully registered securities

then broker-dealers must be mindful to strictly adhere to the provisions in the 1933 and 1934 Securities Acts in these areas and not sell unregistered securities, nor use the same security symbol for multiple types of unregistered placeholder securities.

Also, before broker-dealers use "securities entitlements", "FTDs" and other placeholder securities, they should ensure that there is a legal foundation for their use, since the SEC has no rules in this area.

What is clear from the comments and the data is that both the grandfather provision and the market maker exemptions, not just the options market maker exception, must be eliminated entirely, as they explicitly rely on violating provisions of the Securities Acts, since they rely upon the creation and trading of unregistered securities. They also rely on the simultaneous use of one trade symbol for multiple types of securities, which the SEC has not permitted by any rules.

The SEC's statutory obligation of enforcing existing provisions in the Securities Acts leaves the SEC no choice but to eliminate anything that relies on these illegal activities.

The APA Requires Empirical Evidence Justifying REG SHO Rules

Neither the SEC nor any of the comment letters have provided empirical evidence demonstrating that either the market maker exemption or the grandfather clause are justified by data. No benefit is shown or proved. Thus, without empirical data and justification, delivery failures, the sale of unregistered securities, the grandfather clause and the market maker exemption in REG SHO cannot be permitted per APA rulemaking guidelines.

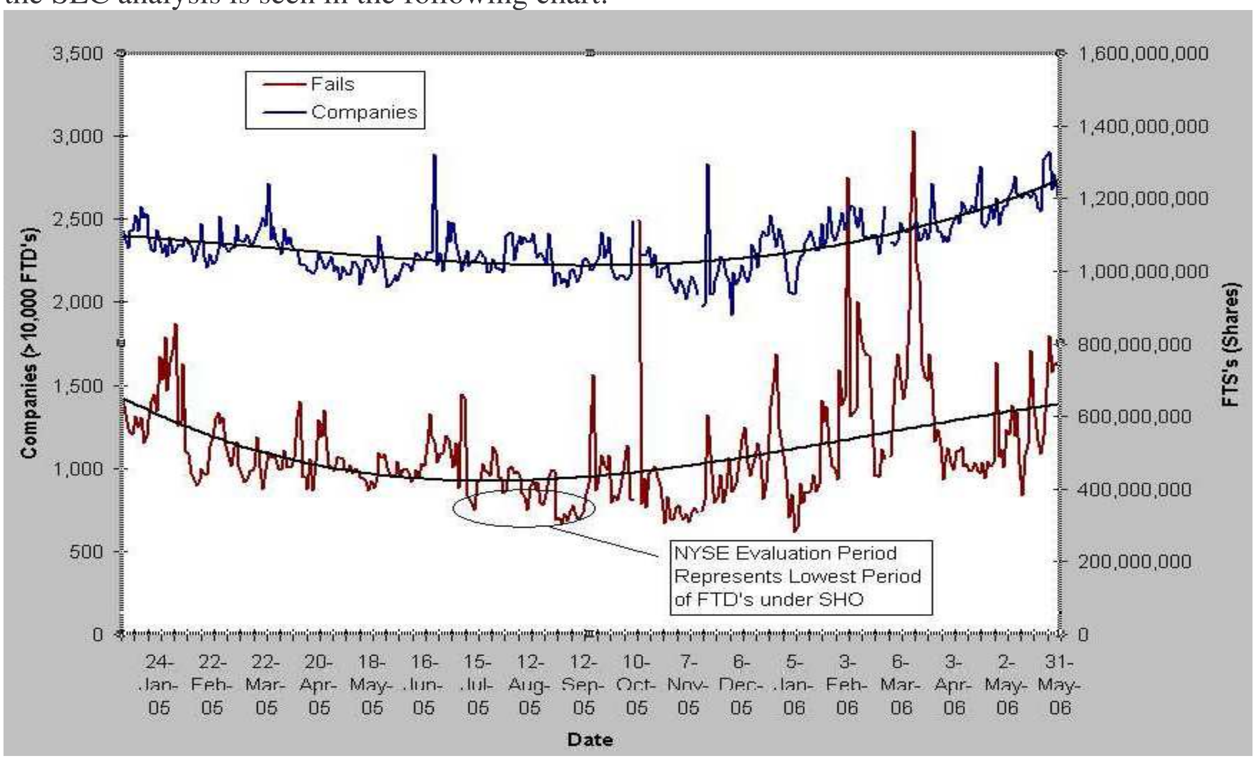
The stated benefits of the market maker exemptions and the grandfather clause are not supported with any data. The SEC and comment letters merely offer conjecture and opinion that liquidity improves, or that bid/ask spreads improves. The same can be said of comment letters supporting these REG SHO rules. Where is the data required by the APA? Where is the data the SEC asks commentators to provide in its proposed rulemaking, showing a benefit? So far data proving a benefit is totally absent.

If there is no benefit, then these rules are unnecessary. And if there is a negative effect, then the APA and the statutory obligation of the SEC dictates that these rules not be implemented in the first place, and be eliminated in an amended proposal. The only evidence that has been supplied thus far, shows a negative effect. Per the APA, this requires the SEC to remove the market maker exemption and the grandfather clause completely.

Also, in evaluating the general effectiveness of REG SHO, the SEC has used an incomplete data set from the NSCC. The SEC states:

> *For example, in comparing a period prior to the effectiveness of the current rule (April 1, 2004 to December 31, 2004) to a period following the effective date of the current rule (January 1, 2005 to May 31, 2006) for all stocks with aggregate fails to deliver of 10,000 shares or more as reported by NSCC:*
>
> - *the average daily aggregate fails to deliver declined by 34.0%;*
> - *the average daily number of securities with aggregate fails for at least 10,000 shares declined by 6.5%;*
> - *the average daily number of fails to deliver positions declined by 15.3%;*
> - *the average age of a fail position declined by 13.4%;*
> - *the average daily number of threshold securities declined by 38.2%; and*
> - *the average daily fails of threshold securities declined by 52.4%.*
>
> *Fails to deliver in the six securities that persisted on the threshold list from January 10, 2005 through May 31, 2006 declined by 68.6%.*

However, the analysis is misleading. The period that is used by the SEC, misleads one into thinking that REG SHO is "working." However, the full context of the selected period used by the SEC analysis is seen in the following chart:



Clearly, REG SHO is not "working", or rather, having any positive effect for investors, as the numbers show. The situation REG SHO was created to fix is worsening as a direct consequence of the market maker exemption and the grandfather clause, as admitted by the NYSE and the NASD. Based on this evidence, the APA, the SEC's statutory obligation and the goals of REG SHO dictate that the grandfather clause and the market maker exemption must be eliminated.

<u>Further Examination of Evidence As Required By The APA</u>

The typical industry arguments can be seen in a letter by the American Bar Association, which on September 27, 2006 – well past the cut-off deadline for comments on the REG SHO amendment - included this in their comment letter:

The Committee believes the Commission should adopt changes to Regulation SHO only if the Commission has substantial reason to believe such changes are necessary after providing the public with the opportunity to comment on the information considered by the Commission in making its decision. As the Commission regularly notes when discussing the regulation of ***short sales****,* ***short selling*** *provides beneficial liquidity to the markets and enhances the price discovery process, so we believe the Commission should not create unnecessary regulatory obstacles to short selling. The proposed elimination of the grandfather provision and the limitation of the options market maker exception may cause adverse consequences, including decreased liquidity and increased opportunities for manipulative short-squeeze activity in connection with close-outs. (emphasis added)*

Examining the statements by the ABA, in this typical comment letter supporting the current rules and advocating no changes, the ABA makes claims regarding the benefits of short sales, **not naked short sales or delivery failures** – which misses the point of REG SHO. This explanation is irrelevant to REG SHO's effectiveness, and the justification for the market maker exemption and the grandfather clause. The ABA omits any explanation and data to support continued delivery failures, or the alleged harm an amended REG SHO may cause, and provides no data to support the benefits of the current rule. So in discussing short sales, the ABA misses the point, as the concern of REG SHO and the REG SHO amendment are fails to deliver:

"One of Regulation SHO's primary goals is to reduce fails to deliver." (SEC)

The ABA also fails to explain how exactly the "price discovery process" benefits by short selling, much less by the market maker exemption or the grandfather clause - and no evidence is provided. It's all rhetoric and opinion, despite the ABA's insistence upon evidence-based rulemaking. The ABA fails to provide any, and is typical of securities industry comment letters.

The ABA also provides no evidence to support its claim on the negative consequences that "may" happen if REG SHO is amended. It's also all opinion and fear-mongering.

The ABA is also hypocritical in supporting the grandfather clause when it reminds the SEC of the APA requirement for public comment periods on proposed rules before they are finalized - since the grandfather clause itself was never proposed nor received any public comment period.

The ABA also calls for evidence that delivery failures may be caused by reliance on the grandfather clause or the market maker exemption. This proof has now been provided in the NASD letter of March 2007 to the SEC and NYSE, which clearly states that delivery failures are likely *due* to the reliance on these two rules.

On the other hand, there is no doubt that delivery failures harm investors. There is plenty of empirical evidence provided within the comment period deadline to the SEC. Take the case of Sedona Corp. where delivery failures were endemic, as has been made public. The SEC has even prosecuted a securities broker for causing delivery failures in Sedona's registered securities. During the time the number of delivery failures substantially increased, the price plummeted, as is logical, and documented. Not only were investors harmed by the high number of delivery failures, but employees were laid off as funds from the capital markets were closed to Sedona due to the fails – this period saw the employee count decline from 70 to 15. This is hardly the kind of investor and public protection the SEC has a statutory obligation to uphold.

Or take the data on delivery failures after REG SHO took effect, provided by TASER in its Sept 18, 2006 comment letter to the SEC:

On February 15, 2005, while listed as a threshold security, an estimated 5.6 million TASER transactions involved fails to deliver on a trading volume of 22 million short sales. Similarly, on March 22, 2005, while still listed as a threshold security, an estimated 8.8 million TASER sales involved fails on a trading volume of 19 million short sales.

Further, FOIA data shows that on January 03, 2005, there were 65 million shares of failed deliveries in NYSE issues, with a total of 552 total issues with greater than 10 thousand delivery failures. On May 31, 2006, there were 65 million shares of failed deliveries in NYSE issues, with 590 total issues with over 10 thousand delivery failures.

Further proof of the trend is seen in the recent SIFMA report published in April 2007 on the liabilities of its NYSE member broker-dealers for Q4 of 2006, which reports that the outstanding liabilities in failure-to-deliver securities was $44.614 Billion. So in a mark to market valuation, the value of delivery failures is clearly increasing, as in Q3, this amount was substantially less. $44 Billion is a lot of delivery failures with the trend going the wrong way without even considering the liabilities of non NYSE member firms, nor the number of FTDs masked by repo agreements.

The empirical data shows that the number of delivery failures is increasing and the clear reasons are the market maker exemption and the grandfather clause.

Supreme Court Ruling

In the case **MASSACHUSETTS *et al. v*. ENVIRONMENTAL PROTECTION AGENCY *et al. No*. 05-1120** decided on April 02. 2007, the opinion of the Supreme Court of the United States is that if a federal agency has authority to regulate provisions of a federal act, then it cannot decide to avoid this statutory obligation. A decision to avoid its statutory obligation exceeds the scope of its discretion under the law.

The Securities Acts oblige the SEC to prohibit any activity that harms investors, and oblige the SEC to enforce the prohibition on the sale of unregistered securities, creating the SEC's statutory obligation to eliminate the market maker exemption in REG SHO as well as the grandfather clause.

This Supreme Court opinion confirms that the SEC, as a federal agency, cannot choose to ignore its statutory obligation in regard to the harm caused to investors by delivery failures of registered securities, which in turn are caused by the market maker exemptions and the grandfather clause.

The same argument applies in regards to the issuance, sale and trade of unregistered securities. While the Securities Acts expressly prohibit this activity, the SEC has decided not to enforce this prohibited activity - without any public justification or final rule. The Supreme Court decision dictates that the SEC must live up to its statutory obligations by stopping and prohibiting the trade of all unregistered securities as well.

The SEC's decision to ignore the provisions in the Securities Acts that prohibit the trade of unregistered securities is especially grotesque given that the SEC relies upon its ignoring this statutory obligation, when formulating its new REG SHO and rules permitting delivery failures.

Only if the SEC decides not to enforce and regulate provisions in the Securities Acts that prohibit the trade of unregistered securities, are delivery failures even possible.

Proof of Unregistered Securities

Clear evidence of the sale of unregistered securities and the simultaneous use of the OSTK trade symbol for multiple types of securities can be seen in the position report listed bellow for OSTK registered securities dated January 12, 2006. This table clearly shows that 10,377,610 registered securities of OSTK are being credited to investor accounts, while 6,703,630 of these securities are not OSTK registered securities, **but merely unregistered placeholder securities wholly lacking any of the rights of the genuine article**. The broker-dealers as financial intermediaries are issuing and crediting unregistered securities to investors that are not genuine registered OSTK securities, while simultaneously using the same OSTK security symbol to represent different types of securities.

There is no provision in the Securities Acts nor is there a formal SEC rule that permits the use of place holder securities nor the intermingling and indiscriminate use of trade symbols in this manner. However, the Customer Protection Rule or Rule 15 (c) 3-3, obliges the broker-dealers to keep track of all securities in regards to investor accounts.

While the SEC has stated – without making formal rules to the effect - that, per U.C.C. 8, broker-dealers may credit “securities entitlements” to investor accounts, this gives permission to falsely represent one security (a security entitlement lacking a delivered underlying genuine security) by using the trade symbol of another. Additionally, as per provisions of the Securities Acts, “securities entitlements”, being securities themselves, must be registered with the SEC as well.

This doesn’t occur.

Whether securities lending or delivery failures creates the need for placeholder securities is irrelevant. The SEC must live up to its statutory obligation and prohibit this illegal activity.

Participant Name	DTCC Position (1/12/06)	Beneficial Ownership List (1/12/06)	Difference
Goldman Sachs	1,024,234	2,720,747	1,696,513
Citigroup	88,706	1,031,596	942,890
City Securities	-	811,972	811,972
Morgan Stanley	86,258	705,356	619,098
Barclays Capital	147,287	577,196	429,909
NFS LLC	937,315	1,354,520	417,205
Lazard	50	309,750	309,700
Charles Schwab	388,346	665,178	276,832
Merrill Lynch	145,673	415,977	270,304
UBS Securities	293,834	515,131	221,297
Daiwa Securities	-	159,100	159,100
Bear Stearns	22,508	180,059	157,551
National Investor	137,624	293,411	155,787
Ameritrade	251,320	383,245	131,925
E*Trade	150,825	254,372	103,547
	3,673,980	10,377,610	6,703,630

REG SHO’s Reliance on Trust is Not Justified

The SEC’s regulatory scheme relies on trust and self-enforcement, despite the fact that pervasive abuse is well documented.

> *Locate Requirement: Regulation SHO requires a broker-dealer to have* ***reasonable grounds*** *to* ***believe*** *that the security can be borrowed so that it can be delivered on the date delivery is due before effecting a short sale order in any equity security.*

The SEC's regulatory scheme has no mechanism to oversee or verify in real time if the locate rules are being adhered to. The SEC cannot possibly meet its statutory obligations to protect investors by relying on unverifiable requirements for broker-dealers and market makers.

The entire regulatory scheme of the SEC in regards to regulating short sales, delivery failures and the sale of unregistered securities is built on this non-regulation. The SEC's requirement for honesty absent a dependable verification mechanism is not regulating per the SEC's statutory obligation.

The abuse and exploitation of the SEC's non-verification scheme is well documented in Operation Uptick. In the year 2000, this operation concluded with the discovery of massive securities fraud involving legitimate market makers, licensed broker-dealers and organized crime, and the arrest of 120 people. Of these, 95 were convicted in 2003.

In testimony taken by the SEC, witness John Serubo of Bryn Mawr Investments confirmed that the mafia was involved in a stock manipulation scheme against Eagletech and many other securities. This scheme involved well known firms such as the Bank of New York, Solomon Smith Barney, Prudential, and many others.

As for Eagletech shareholders, according to SEC documents, there were 1218 retirement accounts that had held this security during the time it was being manipulated. Likewise there were 429 trust funds holding the security during the time of manipulation. There are also unknown quantities of individual shareholders who purchased or sold securities during this scheme to manipulate. Further details can be read in this court filing of the Eagletech complaint:

www.internationalshareholdersgroup.com/pdf/Eagletech_v_Citigroup_Complaint_Filestamped.pdf

While the manipulation discovered in operation Uptick was pre-REG SHO, the new regulations have done nothing to stop delivery failures, as shown by the data, and REG SHO continues to rely on the false hope that participants will abide by the rules, rather than on verification or self-correcting mechanisms, such as the option for buyers to cancel trades when registered securities are not delivered.

Or take the video tape of Jim Cramer on manipulating the securities markets:

> *"A hedge fund that's not up a lot really has to do a lot to save itself now," Cramer said. "When you have six days and your company is in doubt because you're down, it's important to foment an impression that RIM is down, because RIM is the key today."*
>
> *"Then you call the* [Wall Street] Journal *and get the bozo reporter on Research In Motion. And you feed that there's a - that Palm's got a killer [new device] it's gonna give away. These are all the things you must do on a day like today. And if you're not doing it, maybe you shouldn't be in the game."*
>
> *Similarly, it's important for market players who are short* ***Apple*** *(AAPL) to spread rumors that* ***Verizon*** *(VZ) and* ***AT&T*** *(T) don't like Apple's new phone.*

> *Cramer said if he were short the stock, he would call six trading desks and say he just got off with his contact at Verizon, who said that the company has no room for Apple.*
>
> *"It's a very effective way to keep a stock down," he said. "What's important when you're in the hedge fund mode is to not do anything remotely truthful, because the truth is so against your view."*
>
> *It's important for people to recognize that the way the market really works is that it has that nexus of hitting the brokerage houses with a series of orders that can push a stock down, after which rumors get leaked to the press and get on TV, Cramer explained. Then there is a "vicious cycle down."*
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> *"It's a fun game, and it's a lucrative game," Cramer told his host, Aaron Task. "Who cares about the fundamentals? . . . The great thing about the market is it has nothing to do with the actual stocks."*
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> *Cramer added that the strategy - while illegal - was safe enough because, "the Securities and Exchange Commission never understands this."*

At least on the last point we concur. The securities markets are far too large for the SEC to be able to police it in real time. Clearly, self-correcting market mechanisms and the power of buyers to be able to cancel trades that experience delivery failures are needed in place of mere trust. After all, the SEC does not regulate the city library. Too much money is at stake. At the end of this letter, we offer suggestions that provide solutions to this, an other issues raised in our letter.

<u>Severe Credit Risk Exposure of U.S. Securities Markets</u>

Another factor that the SEC has failed to take into account in permitting delivery failures is the credit risk these failures expose the securities markets to. It's not just the mark-to-market valuation of these liabilities that the broker-dealers are exposed to.

Rather, it is the liabilities these broker-dealers are exposing themselves to should these securities pay out dividends.

Unless investors are willing to sell these securities back to the "issuers", namely the broker-dealers, there would be no end to the liabilities broker-dealers would have in paying out cash equivalents to investors, in the event of the commencement of a dividend payout.

There are already several plans being discussed to take advantage of this liability and the SEC has refused to even publicly comment on it, despite the fact that the SEC was briefed on at least one of these plans and invited to publicly comment.

This liability is only possible if the SEC and broker-dealers insist on delivery failures and the sale of unregistered securities.

Exposing the U.S. securities markets to such risk exposure is surely not in the public's interest, so this would be just another one of many arguments and reasons for the SEC to prohibit delivery failures and the sale of unregistered securities in order to fulfill its statutory obligation.

Another confidence crumbling event is the upcoming wave of non cash dividends being paid by victim companies that see large delivery failures. How will the investors receive their non cash dividends if the securities market for that security is full of fails to deliver? The failed securities cannot deliver unique non-cash dividends such as land grants, leaving investors who hold fails deprived of the property rights they bought and paid for.

This system is broken, not to mention it violates the Securities Acts and the statutory obligation of the SEC.

It is entirely plausible that some savvy issuers and investors will exploit the liabilities of the delivery failures to the point where the liabilities won't be able to be paid by the counterparties liable for the fails.

Suggestions and Comments

To address all the problems identified in this letter and to ensure that the regulatory scheme is in compliance with the Securities Acts of 1933 and 1934, the will of Congress, and aligned with protection of investors and the statutory obligations of the SEC, we propose the following solutions prompted by the SEC's question:

> ***"In addition to the questions posed above, commenters are welcome to offer their views on any other matter raised by the proposed amendments to Regulation SHO."***

1. The SEC should enforce the prohibition on the sale and trade of unregistered securities
2. The SEC should require the **registration** of all placeholder securities, like "securities entitlements", FTDs, FTRs, etc., and require the placeholder security symbol be credited to investor accounts, when these types of securities are being credited in lieu of the security purchased. The symbol of the security purchased should only be credited to investor accounts when indeed it has been delivered and the financial intermediary is actually holding it and in possession of it on behalf of the investor (or it is held in trust by the depository).
3. **The SEC should promulgate rules according to the APA that permit and regulate the use of registered placeholder securities, including reliance on these placeholder securities to satisfy the locate requirement, thus permitting instant sale and resale of positions, as in day trading.**
4. In the event of a fail to deliver, the buyer should be permitted to cancel the trade at T+4 or beyond, or the sellers should be required to deliver no later than T+7, at the buyer's discretion.
5. When a security is lent out from an account, a registered placeholder security needs to be credited and the lent registered security debited.
6. Close out requirements should be extended to non-CNS fails as well as to fails in the CNS system, as the Securities Acts and the will of Congress apply to all securities transactions, not just CNS transactions.
7. No money should ever be released to sellers who fail to deliver, regardless of the mark to market situation.
8. To increase efficiency, the SEC should go to a T+0 delivery timeframe, which would eliminate the need for most registered placeholder securities, except in lending activities.

In line with APA guidelines, the SEC is also asking for comment on the following questions:

> ***"Should we eliminate the options market maker exception altogether? Would this impede liquidity, or otherwise reduce the willingness of options market makers to make markets in threshold securities? Please provide specific reasons and information to support an alternative recommendation."***

The empirical evidence pointing to the harm done to investors, issuers and the public due to the delivery failures caused directly by the option market maker exception, coupled with the statutory obligation of the SEC, leaves no other course of action for the SEC but to eliminate the option market maker exception completely.

"Should we consider other amendments to the locate requirement?"

"Thus, should we amend Rule 203(b)(1) to provide for stricter locates?"

The locate requirement should require a mandatory pre-borrow of registered securities from a source that decrements the shares without providing multiple locates to multiple borrowers, before a short sale can be effected. The locate requirement also needs to apply to positions and trades **not in the CNS system**. Additionally, the locate requirement should permit registered placeholder securities to satisfy the locate requirement.

"Can the close-out provision of Rule 203(b) be easily evaded?"

Several participants can fill buy orders from investors by deliberately naked short selling the order in a manner that routes the order away from the CNS system. This can be done in many ways. The simplest way is to "desk" the trade.

Basically, any scheme that keeps the delivery failures off the CNS system circumvents the close out provisions of fails. That is why it is important that at the investor account level, all the games must stop. The correct security symbol needs to be credited to investors to reflect reality. So if it a place holder security is delivered, a place holder security symbol needs to be credited and not the purchased security symbol. In addition, the close out procedures need to apply to all securities, no matter the source of the fail or pre-existing level of fails in that security.

The Customer Protection Rule or Rule 15 (c) 3-3 already obligates broker-dealers to monitor the good delivery of securities purchased on behalf of investors, so this represents no new regulatory burden. The SEC merely needs to start enforcing this important rule.

"Should we consider changing the period of time in which any fail is allowed to persist before a firm is required to close out that fail (e.g., reduce the 13 consecutive settlement days to 10 consecutive settlement days)?"

The simplest, cheapest and most effective and efficient way to ensure delivery failures are closed out across the board is to give the buyer the power to act, rather than relying on the already-failed seller. **This would include letting the buyer decide how long to tolerate the fail and how long it should persist, up to T+7.** Between T+4 and T+7, the buyer should have the option to cancel the trade at any time. Similar to the Adams Respiratory Therapeutics case.

The seller should never receive any funds until the registered security purchased is delivered by the seller to ensure that a cancellation remains possible, and to encourage delivery.

"We understand that deliveries on sales of Rule 144 restricted securities are sometimes delayed through no fault of the seller. Should the current close-out requirement of 13 consecutive settlement days for Rule 144 restricted threshold securities be extended, e.g., to 35 settlement days?"

So is it the fault of the buyer? Should the buyer and the market suffer? Of course not. It is the responsibility of the seller to ensure that the restrictions are all lifted before a sale. The close out requirements for rule 144 restricted stock should not be any different than for any other fails.

"The current definition of a "threshold security" is based, in part, on a security having a threshold level of fails that is "equal to at least one-half of one percent of an issuer's total shares outstanding."[23] Is the current threshold level (one-half of one percent) too low or too high? If so, how should the current threshold level be changed?"

The current threshold definition, ignores non-CNS delivery failures and delays the close out of CNS fails – harming investors and contrary to the goals of REG SHO and in violation of securities laws. So the threshold level should be zero and include non CNS fails.

Specifically, the definition opens the window for unlimited fails and manipulations spanning 18 trade days for CNS fails, not to mention non-CNS fails: for the first 5 days before the security becomes a threshold security and the 13 days after it becomes one but before REG SHO close out requirements kick in. 18 trading days is almost a calendar month to leave CNS fails open, and offers plenty of time to manipulate a stock in this way.

The 18 day delay and the ignoring non-CNS fails should be eliminated by setting the threshold level to zero and expanding the source of fails to non CNS fails, as the securities laws apply to all trades.

All fails in all securities should be subject to the same close out requirements, not just to threshold securities or fails located in the CNS system. The close out requirement needs to apply to all fails including non CNS fails.

That is a way to automatically keep the level of fails low in the first place and ensure the security and investors and issuers don't not become a victim of manipulative naked short selling.

If defined this way, the threshold definition and security becomes a built in market mechanism that automatically helps ensure that delivery failures are cleared up and investors and issuers are protected for all fails, and not provide a visible tool for manipulators to actually legitimize delivery failures by using non CNS fails and the wide time line in the current definition that makes manipulation possible.

"Should firms be required to prohibit all short sales in that security by an account if that account becomes subject to close out in that security, rather than requiring that account to pre-borrow before effecting any further short sales in the particular threshold security?"

We agree with the approach of prohibiting short sales by accounts that have open fail to deliver positions. It is a good solution and ensures that harm is limited to one account. This should apply to all accounts responsible for all fails, not just CNS fails. The broker-dealers now know which accounts are causing fails without relying on CNS to tell them, so these accounts should be restricted from causing further harm by the broker-dealers, till these accounts close out the fails.

"Some people have asked for disclosure of aggregate fail to deliver positions to provide greater transparency. Should we require the amount or level of fails to deliver in threshold securities to be publicly disclosed?"

The benefit would be greater market transparency and better investment decisions on the part of investors. How is that bad? It could also warn investors and issuers of abusive activity, thus protecting them, which is the statutory obligation of the SEC. The level of fails should be disclosed daily.

We believe that the solutions mentioned under Suggestions and Comments are all necessary to protect investors and the public and will not harm liquidity or execution speeds or options in the equity securities markets, so long as the locate rule is adjusted to be satisfied by the possession of registered placeholder securities.

These solutions also automatically enforce the close out of fails and are in line with the Securities Acts. They also eliminate the illegal sale and trade of unregistered securities and the misrepresentation of securities to investors by using one trade symbol for multiple types of securities simultaneously.

Our solutions would also offer better market data and transparency to investors, improving efficiency. The current problem is evidenced by a Bloomberg article dated September 11, 2006 :

> *Off-Exchange Trading*
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> *About 37 percent of trading last month in NYSE-listed companies, such as Wal-Mart Stores Inc. and Exxon Mobil Corp., was done off the exchange, data compiled by New York-based investment bank Sandler O'Neill & Partners LP show. That's up from 18 percent in 2002.*
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> *One in five of the shares traded in the U.S. during the second quarter bypassed the exchanges and were matched either internally among brokers' own clients or through anonymous electronic markets, according to Aite Group LLC, a Boston-based consulting and research firm. That proportion will increase to about 25 percent by 2010, Aite Group estimates.*
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> *Bank of America Corp., the second-biggest U.S. bank, said it traded 22 million shares of Oklahoma City-based oil and gas producer Chesapeake Energy Corp. between April and June. The NYSE said only about half that much could be traced to Banc of America Securities LLC.*

We believe it's important to include all fails in the close out requirements, including ex-clearing fails, and we believe our suggestions and comments help achieve that in a manner that is efficient, in accordance with the Securities Acts and in line with protecting investors and the public.

Our solutions would also not disrupt the market for investors and keep liquidity in the equities market at similar levels as they are today. Nor do they require more recordkeeping burdens than are already on the books as extensive recordkeeping is already required by all participants.

We hope the SEC is sincere in meeting its statutory obligations and protecting investors and we look forward to the REG SHO amendments being finalized in a manner that corrects the current problems.

Should the staff or anyone at the SEC wish to contact us, please feel free to email us at NCANS.Mgr@gmail.com.

Sincerely submitted,
NCANS