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Individual Investor

October 17, 2006

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 :

It is with dismay that I read the distortions and half truths by Wall Street firms and those that represent them in their comment letters to the SEC regarding the amendment of REG SHO. So I feel compelled to set the record straight and offer further comments to the SEC as it affects the reasoning behind any changes to REG SHO.

Close out requirement for Rule 144 restricted securities

Wall Street firms have appealed to the SEC to keep open or even widen yet another loophole in delivery obligations and an exemption to the Securities Acts, this time for restricted securities.

If these loopholes are maintained or even broadened, it will be an avenue for fraud and continued delivery failures. Securities are restricted for a reason. Any errors, difficulties, inconveniences and expense in having these restrictions lifted should be born by the person owning the restricted securities. Existing equity investors should not be exposed to yet more delivery failures and possible fraud for the mere convenience of a few who may themselves be selling before the restrictions are lifted. Any burden should be placed where it belongs and certainly not on equity investors.

Rule 144 restricted securities simply should not be used for collateral for delivery failures for among just a few reasons that come to mind:

- Companies may issue 144 restricted securities for a discount to raise money, believing there is a one year hold, not realising the SEC has already created a huge loophole. The perpetrators can take them outside the US, use them as collateral and sell them the next day in the US markets forcing the stock price down to the discount level. The placement

money comes from retail investors and the profit goes to the SEC authorized participant failing to deliver.
- Sometimes the perpetrators are insiders. They lend stock and the loaners can sell them the next day.
- Sometimes companies refuse to lift the 144 restriction because the share was not valid (part of a failed death spiral, for example).

Equity investors are fed up and so are companies that are listing and doing IPOs at ever greater numbers on competing foreign exchanges. REG SHO must treat Rule 144 securities like any other security and provide no exemption from delivery and close out obligations for these securities and not permit them from being used as collateral for delivery failures.

<u>CBOE and the market maker exception</u>
I implore the SEC to see through the CBOE comment letter as nothing more than the CBOE asking to maintain it's free subsidy at the expense of equity investors. The CBOE tries to distort and put lipstick on their ugly subsidy by not even acknowledging that they hedge via delivery failures every single day. Instead these are called "residual" positions.

What ever anyone calls them, old and new delivery failures that are caused by hedging activity of the option market makers and dealers come at the expense of equity investors. The CBOE never mentions that inconvenient truth.

The CBOE insinuates that if the market maker exemption is eliminated or narrowed, that the options market makers will not be able to hedge any more via short selling or that this activity will be hampered. Nothing could be further from the truth. Options market makers will be able to short sell like before and like anyone else if they pre-borrow and not FTD. The pricing and spreads of the cost to hedge via securities borrowing or securities futures will just have to be borne by the benefiting parties – the participants in the derivative markets. Equity markets and investors should not be negatively affected by the actions in the derivative markets. Period.

The CBOE letter also misrepresents that options market makers hedge in a market neutral way. However, it was clearly explained in another letter written to the SEC by an option market maker that this expression means the hedge position is neutral only for the market maker - not the equity market, as the equity market doesn't receive the benefit of option premiums or spreads paid to them or other benefits of options trading - only the options market makers receive these benefits. There is no guarantee in any way shape or form that options market makers will only hedge in a near market neutral way from the perspective of the equity market (Stock Market). None what so ever.

It also strikes me that the CBOE says FTDs are no big deal so it's not necessary to do anything because FTDs are only a very small problem, yet in the same letter say that to actually do away with this very small problem would have enormous consequences. Eliminate the grand fathered delivery failures anyone? The spin is so transparent it's almost funny.

The arguments the CBOE puts forward is for the concern to their business and to parties the CBOE represents, regardless of the fact that equity investors are harmed by CBOE practices of continued delivery failures and failures to even close out old FTDs. Nowhere, is there a mention of the protection of equity investors in their reasoning, which is what the amendment to REG SHO is all about and is the prime mandate of the SEC.

Simply based on this omission alone, the CBOE arguments fail any test of viability. The SEC, based on the limits imposed on it in Section 36 of the 1934 Securities Exchange Act simply can not allow the CBOE and it's members to continue harming equity investors.

The SEC must protect equity investors by eliminating the grandfather clause and eliminating the market maker exception entirely.

<u>Foreign Exchanges</u>

The SEC must be aware that US security markets are falling further and further behind foreign exchanges in many ways, including their share or world capital, listed issues and IPOs. If the SEC fails to re-establish faith in fair security markets in the US, then the negative effects will be wide ranging for the Unites States of America.

But the silver lining is that the good aspects that have made foreign markets so robust and competitive can be implemented here in the US as well, so long as the SEC is willing to do so. Many Wall Street letters, the CBOE as a prime example, insinuate that there is no other way and that making drastic changes endangers the security markets and investors. But if this were true, how does Wall Street explain the gaining market share of the foreign markets that precisely do operate differently? Well hey simply don't. Another omission.

Japan for instance has announced it is going to straight through processing, and India is doing the same, moving to T+0 shortly. And markets in Europe are shutting down all new naked shorting, and related fails, and forcing gradual liquidation of existing fails.

Specifically, the AIM market in London is adopting the same rules, linked to a study began in 2001 by the FSA. The UK has adopted these rules across the board. Germany has moved to stop all new naked shorting on its exchanges, and is forcing a gradual workout of existing fails. Switzerland has enforced three day settlement for years without wavering. They don't look very stupid right now. India's SEBI rejected the DTCC model for its custody system, and permits neither naked shorting nor fails. Japan's JASDEC has announced it is moving to straight through processing.

So the SEC should keep in mind what's happening around the globe and that despite what Wall Street letters claim, there are other and more efficient ways to clear and settle trades to the **<u>benefit</u>** of all parties involved. In all the Wall Street comment letters there is no mention of any of this. The fact that foreign security markets are gaining on the US markets or that they operate entirely different without massive delivery failures is not mentioned in Wall Street comment letters to the SEC because it's an inconvenient truth.

I ask that the SEC protect investors, by eliminating the grand father clause, eliminating the market maker exemption (even for specialists), and treat all security classes (including rule 144 restricted securities) and all investors equally. Failing to do so would only further erode the confidence, reputation and competitiveness of US markets and cede ground to foreign exchanges and open the flood gates to litigation, which would only accelerate the decline.

It’s critically important for the SEC to avoid this outcome.

Sincerely submitted,

Thomas Vallarino