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Individual Investor

August 31, 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 :

I am please to offer my comments on the proposed REG SHO amendments.

<u>Eliminate the grandfather clause</u>
Firstly, I believe that the existing grandfather clause needs to be removed if any believable market integrity in the securities markets in the US is to be re-attained. Too many investors like myself have become disillusioned with the fact that the SEC, charged with protecting investors, has granted an exemption to market participants from certain delivery requirements, encouraging them to keep previously undelivered securities in a failed delivered status indefinitely.

The reason the SEC has given for these exception are for the protection of market participants, volatility and short squeezes. These potentially endangering consequences of closing out very old and persistent delivery failures are only dangerous to those who failed to deliver in the first place, not to investors of the equity security in the equities securities market.

<u>Eliminate market maker exceptions completely</u>
Though the SEC is considering narrowing the market maker exception that currently exists in REG SHO, I believe no market maker should have an exemption in the locate and delivery rules at all.

It is especially harmful to equity investors to have derivative market makers (options market makers) failing to deliver securities in the equities markets, with the SEC's blessing, just so that they can hedge their risk exposure in the derivatives markets.

In essence, the equity security markets are bearing the costs of the hedging activities in the derivative security markets. This has to stop. The options market makers have to bear the cost of risk exposure themselves and stop harming the equity market investors for the sole gain of the derivative market makers. There is no reason for equity security investors to subsidize and be harmed by the derivate market participants. Neither liquidity nor any other benefits are gained by equity investors for accepting delivery failures and the subsequent harm to the price of their securities.

Participants in the derivative markets must not be allowed any delivery failures in the equities markets. Each market and their participants must stand on their own two feet in every respect independent of each other. The current situation of market makers in derivates harming equity investors for their gain is unacceptable and must stop.

The only way to achieve this is to eliminate the market maker exception completely, not just narrow it.

Pre-borrow requirement for all short sales

Hand in hand with the elimination with all market maker exceptions, comes the logical step of requiring all short sales to first require a pre-borrow of the securities from a decremented pool of securities, to ensure that the same pool of securities is no concurrently used by multiple short sellers to satisfy their locate requirements. If all market makers located an exclusive pool of securities to borrow when there was a need in the market making activities, then their functions as compared to today as market makers providing liquidity would be virtually unchanged. However, delivery of securities to buyers and clearing agents would be assured and harm to security investors through delivery failure by market makers would be eliminated.

Linking security entitlements to securities

Since Security Entitlements are used by virtually every single broker dealer in the country in the US securities markets to represent securities, it is important that their use is just a closely regulated as that of the securities.

Without closely monitoring and regulating the use of security entitlements, any security regulation can be circumvented by the misuse of security entitlements. Since the value of security entitlements is about the same size and value of all securities, the avenue for abuse is just as large as the securities market itself and is there for of utmost importance to regulate.

Otherwise a parallel universe of trading and abuse can occur and investor money taken, as many already claim exists, simply by broker-dealers crediting security entitlements in accounts in a way that is different from regulations for securities. Basically, broker-dealers must treat security entitlements just are they would have to treat securities and a system of verification and enforcement must be put in place of the current void.

The only way to achieve this is to link all security entitlements credited to investor accounts with all securities in all broker-dealer depositories and ensure that the security entitlements are being treated just like the securities should be treated and in accordance with all securities regulations and laws.

Not having such a system of cross referencing how security entitlements are treated in relation to the securities, is to open the door of abuse the size of the entire securities market.

I believe that the crediting of security entitlements without having a supporting security on deposit is akin to the broker-dealers issuing unregistered securities in violation of the Securities Act of 1933.

In any case, a method needs to be put in place to not only monitor but also enforce either a buy-in of securities or cancellation of these fake security entitlements that are credited by broker-dealers without acquiring the necessary securities or that are credited differently than any securities rules or laws prescribe securities in investor accounts to be treated.

Again, not only is clarification needed that broker-dealers are to treat security entitlements according to securities rules and laws, but a verification and enforcement system needs to be implemented by cross referencing all security entitlements with all securities on deposit by the broker-dealers. This cross referencing system should be simple and cheap to implement via computerized systems and managed by a clearing agent such as the NSCC or the SROs.

Liquidity and markets have limits

I am aware that the commission is gravely concerned with liquidity in the securities market, to the extent that it seems to favor liquidity over the protection of investors and market integrity. So I would like to remind the commission that it must accept that everything has a limit. Allowing derivative market makers to produce delivery failures in equity markets without limit so that they can hedging their risk exposure derivatives, which is in a different market, is just one example of the liquidity concern gone over board. There are limits in each market that can not be exceeded without harming investors and pushing the market out of balance. This imbalance can only be handled though the harming investors or a future correction, harming market participants. In any case, it is not desirable.

The demand for a security with only a limited supply is what makes the market in the first place. Basic economics 101 stipulates that there is always an unlimited demand but only a limited supply. Market by their definition must have limits, otherwise they are not fully functioning not markets.

Closing thoughts

The information already available paints a horrible picture. For example the delivery failures in Global links securities equaling 27 times all issued securities by the corporation or the fact that for the NYSE and NASDAQ markets, outstanding delivery failures equal about 4% if daily volume and on the OTC market it equals about 28% of daily trade volume, speaks of a market out of control in which fewer and fewer investors can have confidence in.

The fact that the misuse of security entitlements contribute to “ex-clearing” fails, and there is no control to verify how security entitlements are treated by the crediting broker-dealers, shatters trust and confidence in the markets even more and makes any security regulation alone, as is being discussed, ineffective and suspect. Security entitlements need to be regulated just as securities to achieve any meaningful level of trust and real market regulation.

I hope the Commission carefully reevaluates it's priorities to protect investors and the integrity of the markets, rather than the desires of security industry participants from creating liquidity and profit and minimizing their risk at the expense of regular investors, especially those in the equity securities markets.

The 1933 and 1934 Acts clearly give the commission specific instructions to do just this and it is appalling that after 73 years, many basic requirements of these congressional acts are still being ignored by the commission. After all, the authority if the SEC to side step the requirements contained in these acts is restricted by section 36 of the 1934 Act, which only allows the SEC to create exceptions to the 1934 Act, "*…to the extent that such exemption is necessary or appropriate in the public interest, and* <u>*is consistent with the protection of investors*</u>…"

Basically, everything points to the protection of investors. And it's only common sense. If the smallest investor is protected, then the largest institution is protected as well. I hope my comments are useful to the commission and that it realizes the importance the current state of disarray has on investor confidence and on the future direction of the securities markets in the United States of America if nothing is drastically changed. There is nothing stopping investors from fleeing to foreign markets where these problems are non existent.

Respectfully submitted,

Thomas Vallarino