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Congress of the United States

House of Representatives

Washington, DC 20515

August 12, 2008

COMMITTEE ON THE JUDICIARY

RANKING MEMBER
SUBCOMMITTEE ON COMMERCIAL AND
ADMINISTRATIVE LAW

COMMITTEE ON NATURAL RESOURCES

COMMITTEE ON OVERSIGHT AND
GOVERNMENT REFORM

WESTERN CAUCUS
CHAIRMAN

The Honorable Christopher Cox
Chairman
Securities and Exchange Commission
450 Fifth Street, NW, Room 6100
Washington, DC 20549-0100

RE: Release Nos. 34-5810757511; File No. S7-19-07
Amendment to Regulation SHO

Dear Chairman Cox,

I commend the Commission's action to strengthen Regulation SHO through the elimination of the grandfather provision, the proposed elimination of the options market maker exemption, and the consideration of increased enforcement. I also commend the Commission's recent action implementing and then extending the July 15 Emergency Order imposing a pre-borrow and hard delivery date before shares of Fannie Mac, Freddie Mac and 17 major financial institutions can be sold short. I am pleased that you continue to speak about the abuses of naked short selling and the need to end this practice.

The Commission was correct to act to prevent manipulation and naked short selling of securities in the 19 protected companies. While I believe the emergency order and its extension were proper and fully justified, I also strongly believe that the same protections accorded to those protected companies must quickly be extended to all publicly traded companies. All companies deserve and expect equal protection from the Commission and its rules. I was pleased to read in the Commission's July 29 announcement of the Emergency Order extension that it intends to "proceed to immediately" consider after the expiration of the Emergency Order a rulemaking "to provide additional protections against naked short selling in the broader market"

While you have publicly acknowledged on several occasions that there is a serious problem with persistent failures to deliver (FTDs), the practice continues unabated, except for the 19 companies protected by the Emergency Order. Indeed, I am informed that FTDs persist for many companies, and that the total volume of FTDs throughout the market now actually exceeds the volume when Regulation SHO was adopted. I believe this is in part due to the loopholes in the Regulation SHO, and the fact that the Commission has not vigorously enforced the regulation until its most recent actions.

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CHAIRMAN'S
CORRESPONDENCE UNIT

Fairness to all companies and investors requires that persistent FTDs must end. To that end, I call upon the Commission to take the following steps:

1. Eliminate Regulation SHO's option market maker exception as soon as possible after the close of the public comment period on August 13, 2008. Since this is the third round of public comments on this proposal, I see no need for a phase-in period, and certainly not for those companies that have been on the Regulation SHO Threshold List for a total of 100 days or more. This action will provide immediate needed relief for the leading victims of naked short selling.
2. Immediately launch and quickly complete a rulemaking proceeding to impose the same pre-borrow and hard delivery date requirements that exist in the Emergency Order on a market wide basis. The naked short selling and associated "short and distort" activities you have described over the past few weeks continue to plague the market as a whole notwithstanding the Commission's adoption of Regulation SHO in 2005, and its 2007 repeal of the Grandfather exception.
3. Direct the Depository Trust Clearing Corporation (DTCC) to provide *current* data to the public on the volume FTDs. While the DTCC provides daily reports of this data to the exchanges so that they can prepare the daily Threshold Lists, it does not provide data on the volume of FTDs to the public. Currently, the Commission (not the DTCC) releases data on the volume of FTDs quarterly, two months after the close of each quarter. By the time of its release, this data is two to five months stale. Companies and the public deserve and need timely information.
4. Clarify that Regulation SHO applies to all trades of publicly registered securities, not just trades that occur within the DTCC. Trades that occur party-to-party (i.e., ex-clearing trades) must be covered by the provisions of Regulation SHO, including pre-borrow and hard delivery date requirements.

I believe serious settlement failures will persist unless the Commission implements these reforms – reforms that the U.S. Chamber of Commerce and other notable commentators have repeatedly requested.

It is well past time for the Commission to take all of the steps needed to end the fraud of naked short selling for all securities. The clear record since the 2005 imposition of Regulation SHO amply demonstrates that the Commission's incremental approach to adopting a modest rule initially followed by making and proposing incremental amendments combined with a lack of enforcement has failed to end the fraud and manipulation of naked short selling. Naked short selling is not an insignificant issue.

I understand that more than 7,000 securities have appeared on the Regulation SHO Threshold List, with more than 800 companies appearing for over 100 trading days. I also understand that there are currently more than 500 companies on the Threshold List, and more than 50 of those companies that have been on the list for more than 100 trading days. I further understand that a conservative mark-to-market calculation of the FTD data released by the Commission shows that

the total value of FTDs on March 31, 2008 was nearly \$8.5 billion dollars – and that more than \$6 billion of that total reflects securities that are or have been on the Threshold List and more than \$3 billion of that total reflects securities that were then currently on the Threshold List.

This dramatic volume cannot be attributed simply to lost certificates. A well functioning capital market should not have any settlement failures large enough and protracted enough to merit inclusion on the Regulation SHO Threshold List. In my view, these statistics largely reflect unabated illegal manipulative naked short selling.

I would appreciate learning the Commission's specific timetable for proceeding with the proposed elimination of the options market maker exemption and the Commission's position on the initiation of a pre-borrow/hard-delivery rulemaking and more timely disclosure of FTD volume data.

I appreciate your consideration of this matter and would be happy to discuss this issue with you and appropriate SEC staff.

Sincerely,



Chris Cannon
Member of Congress

cc: Kathleen L. Casey, Commissioner, U.S. Securities and Exchange Commission
Elisse B. Walter, Commissioner, U.S. Securities and Exchange Commission
Luis A. Aguilar, Commissioner, U.S. Securities and Exchange Commission
Troy A. Paredes, Commissioner, U.S. Securities and Exchange Commission
Eric R. Sirri, Director, Division of Trading and Markets, U.S. Securities and Exchange Commission