

Dear Securities and Exchange Commission,

Re: Comments on S7-05-22
Shortening the Securities Transaction Settlement Cycle

Summary: As far as pressure on the system to move to T+1 and T+0, there is none. The Commission can easily make such moves because dematerialization and technology has made the instantaneous transaction/settlement of stock possible. But the Commission should go further to reform the clearance and settlement system by: reducing the practice of holding shares in fungible bulk under nominee or street name and removing regulations standing in the way of implementing and expanding a Transfer Agent Depository settlement system to aid in faster (T+0), less complex, and increased integrity in the market.

Dematerialization and Its Effects:

In 1973, the Senate’s Securities Industry Study of 1973 Report outlined a new goal of dematerialization, briefly summarized here:

“The Securities Industry Study's recommendations included the following... (iii) that “the Commission be directed to proceed with dispatch toward elimination of the stock certificate as a means of settlement between broker-dealers. . .”¹

I think congratulations are in order. The Commission has successfully dematerialized the vast majority of all issued stocks. In order to achieve this goal, you first immobilized stock into central depositories and instituted a net settlement system with street name share ownership. This was one of several options postulated as a solution to the ‘paperwork crisis’ and was adopted because a form of this type of settlement system was already in use and proven to be effective. However, a different system, Transfer Agent Depository (TAD), was also highly praised at the time.

While a central depository and netting was very effective at achieving the goals of dematerialization in the short term, the use of this type of settlement system has not been without consequences. The practice of netting shares held in fungible bulk in a central nominee name has ushered in a new crisis of Fails to Deliver/ Receive (FTD/R).

It is my opinion that any reforms made to clearance and settlement, as mandated by 17A of the Act, must include solutions for this new crisis.

The New Crisis of FTDs:

FTDs are a known side effect of net settlement as shares held in fungible bulk are not uniquely identified throughout a transaction and frequently results in shares entitled but not delivered to their beneficial owner recipients.

¹ <https://www.federalregister.gov/documents/2015/12/31/2015-32755/transfer-agent-regulations#citation-73-p81954>

The commission should be fully aware of this endemic problem of FTDs as it was explicitly addressed in Regulation short² (REG SHO). These problems were further illustrated through various comment letters received by the commission over the years:

“As noted the utilization of a CCP [Central Counter Party] in a system based upon “novation” is done in order to centralize what otherwise would be a vast network of difficult to quantify counterparty risks that would impede the clearance of the enormous amounts of transactions occurring daily in our markets. In reality nowadays all of this is done electronically through the DTCC [Depository Trust Clearance Corp] participants’ “cash” and “share” accounts utilizing the NSCC’s “Continuous Net Settlement” (CNS) system. In the above example involving the simultaneous delivery of and payment for (“Delivery Versus Payment” or DVP) the securities involved all is good and the trade has legally “settled”. Sometimes, however, the buyer’s rep shows up at this metaphorical “DVP room” on “settlement date” with his bag of coins but the seller’s rep doesn’t show up with any properly endorsed securities. A “failure to deliver” (FTD) has occurred. ... There are a variety of frauds that use this same modus operandi utilizing a theoretically powerless “straw man” or “nominee”. It’s almost as if the muscle bound NSCC management member after “discharging” the delivery obligation goes behind the curtain and puts on a fake body cast and reappears proffering to be “powerless”. This little “NSCC two step” involving the “discharging” of the delivery obligations of its bosses in exchange for “assuming” and “executing” on them followed by pleading to be “powerless” to do so opens up the floodgates to these abusive naked short selling (ANSS) frauds. In no way, shape or form can these frauds be perpetrated without the DTCC and its various subdivisions going well out of their way to not only provide the meticulously designed infrastructure facilitating these frauds but to also be willing to cover them up now that the investing public has become aware of their existence. As to what is the greater crime the commission of the theft or its cover up I’ll leave that up to the authorities.”

-Jim Decosta: comment³ regarding “amendments to REG SHO” SEC Release No 34-58773, File No. S7-30-08⁴

But the practice of fungible bulk FTDs, also caused (and continue to cause) problems with shareholder voting by proxy:

“We are surprised that the Commission has not questioned the underlying cause of vote imbalances in the concept release, and whether the practice of maintaining a fungible bulk of client and firm securities is still an appropriate structure in today's financial markets. The collapse of Lehman Brothers and the identification of fraud such as that conducted by Bernard Madoff gave greater visibility to some of the imperfections in the current "four-tiered" (9) architecture of the US settlement system, and its lack of integrated and systemic safeguards. Safeguards that would better protect investors include: the segregation of client assets from

² <https://www.sec.gov/rules/final/34-50103.htm>

³ <https://www.sec.gov/comments/s7-30-08/s73008-75.pdf>

⁴ <https://www.sec.gov/rules/final/2008/34-58773.pdf>

firm assets; and the use of designated settlement accounts in the DTCC system to prevent client securities within the broker's fungible bulk from being used to cover the broker's settlement obligations, whether they are the firm's own trading obligations or obligations owed on behalf of other clients."

(9)-The "four-tiered architecture" is the hierarchy of relationships between the register (tier 1); registered shareholders, including the registered holding of Cede & Co. (tier 2); the DTCC participants' accounts (sometimes referred to as a "fungible bulk"), where DTCC records ownership rights of individual intermediaries (tier 3); and then the separate databases maintained by each intermediary of their respective client holdings (tier 4). Under this four tiered architecture, there are no independent systematic controls that ensure that the total assets held for clients collectively by all intermediaries reconciles vertically up and down the four tiers in the hierarchy of ownership. This lack of central control means that there can be more security entitlements recorded in the intermediaries' databases than exists within Cede & Co.'s holding of actual securities on the register of shareholders of the company. Various reasons for this imbalance were discussed in our section on "Pre and Post Reconciliation".

-Paul A. Conn : Comment⁵ regarding "Concept Release on the U.S. Proxy System"⁶

"Yet in the referenced Concept Release, the SEC seems to have realized this. As the Release itself admits, the "manner in which proxy materials are distributed and votes are processed and recorded involves a level of complexity not generally understood by those not involved in the process. This complexity stems, in large part, from the nature of share ownership in the United States, in which the vast majority of shares are held through securities intermediaries such as broker-dealers or banks; this structure supports prompt and accurate clearance and settlement of securities transactions, yet adds significant complexity to the proxy voting process.,,(3) It is an anachronism to say that such structure "supports prompt and accurate clearance and settlement of securities transactions." What was true in 1975 is no longer the case in 2010. Once a security exists as a mere electronic booking in a register - as most do today - having the same security booked in layers of intermediary registers adds neither speed nor accuracy to securities settlement. The concept is very simple. The model imposed in 1975 orders paper certificates immobilized in custody accounts so that claims on the securities can be traded quickly as book entries on those accounts. Now that paper securities are rare on exchanges, each security traded already exists as claims on an account. The intermediary booking in the name of a depository's nominee or a broker at best adds nothing to the process and at worst can lead to the creation of securities that were never issued, as intermediaries book claims on accounts that are not backed by actual securities. As explained in the attached paper, if the SEC examines the root of the shareholder communications problem, it will see that disintermediating securities settlement will lead both to a transparent relationship between issuers and securityholders and a safer, more efficient model of securities settlement. The entities that now appear on securityholder lists as registered owners of all listed securities would become relatively invisible

⁵ <https://www.sec.gov/comments/s7-14-10/s71410-257.pdf>

⁶ <https://www.sec.gov/rules/concept/2010/34-62495.pdf>

processors of ownership information. The alternative to this restoration of transparency, continuing to build on a faulty foundation, is just throwing good money after bad.”

(3)- Concept Release on the U.S. Proxy System, SEC Release No. 34-12495, 75 Fed. Reg. 42982, 42983 (July 22,2010) (emphasis added).

-David Donald: Comment⁷ regarding “Concept Release on the U.S. Proxy System”⁸

Increased Complexity, Decreased Transparency:

Many of these comments were in response to regulations that were simply band aid solutions to the bleeding heart at the center of the problem: the adoption of central netting and the holding of securities in fungible bulk, street name, instead of in the names of individual investors. These band aid solutions have compounded the complexity of the system into an untenable mess with so many loopholes making its possible transparency and enforcement a joke.

“...The alternative proposals regarding price rules, circuit breakers and, especially, the “short exempt” rule only serve to add complexity – which is no substitute for innovation. That these regulations have become overly-complicated can be evidence by the increasing size of the associated rulemakings (as published in the Federal Register). The current revisions (73 pages) are almost double the size of the original proposed rule (39 pages) and 3 times the size of the final regulation SHO (25 pages). My proposal, though highly innovative, would make short-selling very straight forward: never fail to deliver and always have a close-out date.”

-Dr. Trimbath: Comment⁹ regarding “Amendments to REG SHO”¹⁰

This proposal for T+1 (leaving out the T+0 request) is 100 pages, for something that should be as simple as ‘I give you my money; you give me the stock; you have 1 day’

Transfer Agent Depository (TAD):

T+1 and T+0 may make the settlement process faster, (Is a FTD in T+0 less egregious than a FTD in T+2?) but more importantly illustrates that we no longer need street name holdings because technology has advanced since 1975.

During the ‘paperwork crisis’ a more transparent and less complex solution was proposed: TAD or Transfer agent Depositories.

“The transfer agent depository “TAD” would replace the certificate with computerized stockowner lists, maintained by the transfer agent, which would serve as both the issuer’s stock records and the shareowner’s evidence of ownership. Following a trade, upon the instruction of a selling customer of his broker, the TAD would transfer securities by book entry from the selling

⁷ <https://www.sec.gov/comments/s7-14-10/s71410-91.pdf>

⁸ Ibid 6

⁹ <https://www.sec.gov/comments/s7-08-09/s70809-3365.pdf>

¹⁰ Ibid 4

customer's account to the buying customer's account and would notify the customers and their brokers of completion of the transfer. The transfer would be performed by means of a message-switching center interposed between the customer or broker and each transfer agent.

"To the extent the stock certificates were eliminated, the interpositioning of a computer switching center between the transfer agent and the broker and banking communities would permit multiple high-speed transfers of record ownership. Therefore, securities could be held in the name of the beneficial owner without disrupting the system for clearing and settling securities transactions. Customers wanting to maintain privacy or owning securities through arrangements requiring the intervention of an intermediary could continue to register the securities in the name of the intermediary."

-Final Report of the Securities and Exchange Commission- on the practice of recording the ownership of securities in the records of the issuer in other than the name of the beneficial owner of such securities. (street name study)¹¹

A lot has changed since 1975 when the Commission reported that technology was not up to speed and dismissed the TAD method of clearing and settlement as a possibility. Specifically:

"The principal concern regarding TAD, even among those commenting favorably, was the belief that problems involved in its implementation were too significant to make TAD a short-term alternative. One issuer stated, "assuming that a 'Certificateless Society' was an immediate possibility, this alternative could be very beneficial... However, in reality, because of time and standardization costs, we feel that there would not be an immediate enough benefit from further consideration of this alternative." A large broker commented that, "although this alternative is attractive and will probably be a necessary development in the goal of a certificateless society, we believe that there are other steps which need to be taken... before we can use such a system for the distribution of proxy material." A major west coast bank stated: "the transfer agent depository concept... may have some long run promise, but it would seem to presuppose a highly integrated national computerized 'book entry' system which simply doesn't yet exist."

-street name study¹²

Fortunately, the DTC (Depository Trust Company) and others over the many years since the 'paperwork crisis', devised solutions for these problems in the form of the Direct Registration System (DRS). This system proves that transfer agents are now technologically able to handle transactions taking place directly on their books and that brokers are able to directly communicate with these agents to effect settlement.

¹¹https://books.google.com/books?id=J33QAAAAMAAJ&printsec=frontcover&source=gbs_ge_summary_r&cad=0#v=onepage&q&f=false

¹² Ibid 11

TAD has Proven to Work:

The use of the Direct Registration System by the majority of transfer agents and issuers illustrates that the DTCC itself recognizes the benefits of decentralized depositories, as these transfer agents already are in possession of the Jumbo certificate evidencing those shares owned by CEDE and Co.¹³

In addition to the DTCC's own recognition of the ability for TAD to be a viable method of efficient settlement, other settlement systems that allow for individual ownership have proven effective. The Iberclear Central Securities Depository System in Spain allows many of the market functionality that some deem "important" to occur without sacrificing the limitations of issued shares and allowing individual ownership to be recorded on the books of the issuer. This system offers a solution to how someone might short a stock without rampant rehypothecation and overleveraging issues that plague our markets today.

"Note how securities "lending" occurs in this system. Because securities "lending" is really a transfer of a security subject to an obligation to retransfer an equivalent security later, the securities "loan" itself would be recorded on the registry as a transfer (with the "return" similarly recorded). Thus, the system forces an attribution of "lent" shares to specific accounts, with notice to the account holder, while also ensuring that no more than 100% of the shares appear. Because each securities loan involves an actual recorded transfer of shares on the registry, the cost of securities lending may increase, as intermediaries will not be able to lend securities out of the "float"—the aggregate of shares which are unlikely to be sold during a given period."

-Edward Rock, The Hanging Chads of Corporate Voting¹⁴

Street name and Nominee name Holdings are Not Necessary:

Current technology allows for direct holding to happen and will only improve with the expanding use of blockchain. Crypto exchanges show that ownership by a central organization is no longer necessary. Certified numbers can easily be connected to each transaction and ownership can and should be tracked. FTDs can be eliminated when specific shares must be recorded on each transaction. Blockchain technology is fully capable of this and is already in use.

Allowing street name registration and netting to continue to be mandatory for trading in the marketplaces in the name of "dematerialization" is dishonest. At least admit that it is to maximize the profitability of financial companies that use the unnecessary complexity of the system to take advantage of individual investors who have no access to invest capital in businesses of their choice otherwise.

Many of the proposal considerations in this request for comment are attempts to regulate this mess of 'fungible bulk's' own making. For instance:

¹³ <https://www.dtcc.com/-/media/Files/PDFs/DTCC-Dematerialization-Whitepaper-092020.pdf>

¹⁴ https://www.academia.edu/70550937/The_Hanging_Chads_of_Corporate_Voting

68) "Liquidity risk refers to the risk that the market participant will be unable to timely settle a transaction because it does not have access to sufficient cash or securities." This risk is gone if you require the shares to be transferred and cash to be available at the time of the transaction. END OF RISK
Naked shorting (which is illegal) can't happen in a system that doesn't work unless the shares are allotted ahead of the transaction. END OF CRIME

76) Eliminating multi-lateral netting as in TAD settlement, will come with the added benefit of eliminating FTDs. This result should be pursued without grandfathering in netting systems that produce devastating overleveraging risks.

77) You can't overleverage something that has to be produced when it is bought.

78) When a person purchases anything outside of the markets, the item they purchase is delivered, in general, immediately. I can't buy eggs if I don't have the money, and you can't sell me eggs that you don't have. The Spanish Iberclear system of shorting¹⁵ remedies this situation.

80) Street name could still be used and netting utilized at the broker level. They already do this with internalized trades. Mutual Funds and ETFs could be used within their own street name facilities if their customers prefer.

116) If individual share identification is achieved, recalling a portion of loaned shares isn't a problem. Again, fungible bulk creates this problem.

123) Introducing false liquidity impairs price discovery. "Short selling may be an investment strategy, but it is in no way critical to price discovery. Quite the contrary. It is when investors want to purchase shares that are not available, or to sell shares that are not in demand, that price discovery occurs."- Dr. Trimbath¹⁶

126) Many brokers already require retail investors to prefund their purchases for T+2. This standard would bring back validity to the market. If you want to buy something, the seller makes sure you have the money or funding for it ahead of time. Why are the rules on Wall Street above the laws on Main Street? The EU is already implementing a Settlement Discipline Regime (SDR), a reduction in FTDs can only help integrate with systems there.

When will the risks to the human members of society be considered above the risks to financial institutions?

IV. Pathways to T+0

I was happy to see that the commission included an option for **real-time settlement, on a gross basis without netting** (Pathways to T+0 method ii) This is important because it appears that the 1975 commission felt that it was part of their duty regarding section 17A of the Act to further investigate the possibility of moving towards a TAD system when technology advanced:

"The TAD concept exhibits promise as an important long-term alternative. It is not, however, a system for streamlining communications but rather an approach to a national clearance and

¹⁵ Ibid 14

¹⁶ <https://www.sec.gov/comments/s7-08-09/s70809-3365.pdf>

settlement system which, as a by-product, would improve issuer-shareowner communications. Development of TAD, therefore, must be integrated with other developments in clearance and settlement. **The Commission will continue to encourage consideration for the TAD system in carrying out the Commission’s responsibilities under Section 17A of the Act. “**

-street name study¹⁷(emphasis added)

IV. A. 3. **Tiered Implementation beginning with pilot programs** would offer the ability for competition to fine tune the processes and mechanisms that would make true real-time settlement and ownership of shares a reality for retail investors. In addition, decentralization of settlement processes may be a more effective way to regulate: allowing the free market to push the best practices to the fore front.

In this same vein, it is imperative that the Commission **repeal** “Rule Change Amending FAST and DRS Limited Participant Requirements For Transfer Agents” Release No. 34-57362; File No. SR-DTC-2006-16¹⁸

The restriction that transfer agents may not effect the transfer of a security outside of the DTCC system is a legalization of a monopoly. If transfer agents were allowed to transact trades on the books of the issuer without the intermediary of the DTCC, not only would the monopoly of the DTCC be broken but true free market competition would foster improvements in settlement. By not allowing transfer agents the ability to transact with the exchanges, you are restricting both the innovation that would come with competition and the completion of the SEC’s dematerialization goals.

137) Elimination of paper certificates should be pursued but an increase of individual direct ownership should be encouraged.

138) Digital transfer of assets is necessary for T+0. Digital ledgers and NFTs offer the ability to have verifiable transfer of assets without certificates.

140) Dematerialization should be encouraged with individual ownership. Allow individual companies to ask their beneficial owners to register their shares and the dematerialization will happen on its own. So you will need to **repeal** this “Rule Change Concerning Requests for Withdrawal of Certificates by Issuers” Release No. 34-47978; File No. SR-DTC-2003-02¹⁹

Let Us Own and Trade our Own Stock!

Individual investors want to be able to own and trade their own stock. When GameStop investors learned about how they did not fully own the stock they were purchasing through brokers, the number of registered stockholders increased from 1,600 to 125,000 in ONE YEAR. That is a 7,800% increase. The people want to own their own stock!

¹⁷ Ibid 11

¹⁸ <https://www.sec.gov/rules/sro/dtc/2008/34-57362.pdf>

¹⁹ https://www.sec.gov/rules/sro/34-47978.htm#P38_14490

In light of one of the SEC's main goals, "protecting investors":

The time to consider the undue burden to the financial industry is over!

It is time to consider the undue burden entitled FTDs has put on individual investors!

The time of needing Cede and Co ownership for all shares traded on the market is over! (We thank them for their service.)

It is time for the PEOPLE to OWN and trade their own stock!

Recommendations:

1. In the Commission's investigations of the move to T+0, please consider what changes to the "plumbing" will ensure that these obligated FTDs and FTRs are delivered.
2. SEC should create a Blue Ribbon commission to establish the facts regarding why FTDs are occurring (both in CNS and Ex CNS) and take steps to eliminate this risk and move towards a more transparent, less complex market system
3. SEC should close all reporting loopholes in REG SHO. Every fail whether in CNS, OCC or Ex-clearing should be reported both to the SEC and to the general public.
4. SEC should require every clearinghouse participant in the market system to report how many shares they are entitling to their customers (encompassing all introducing brokerages) and contrast that with their actual street name ownership for each issue! This should be reported directly to their customers (and the SEC) with information on how to hold their shares directly in their own names if they so choose. (If not, why is retail ignorance of these facts necessary for the system to continue to function?)
5. SEC should repeal the "Rule Change Amending FAST and DRS..."²⁰ and allow Transfer agents to buy and sell stock for individual stockholders without having to use brokers and registering and deregistering in the name of CEDE and Co as an intermediary.
6. SEC should repeal the "Rule Change Concerning Requests for Withdrawal of Certificates by Issuers"²¹
7. SEC should implement a Transfer Agent Depository (TAD) system on an opt in basis for each transfer agent. Then see what happens (The Commission knows it is the right thing to do!)

Sincerely,

JMP

²⁰ Ibid 17

²¹ Ibid 18