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September 25, 2006

Ms. Nancy Morris
Secretary
United States Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Release No. 34-54154; File No. S7-12-06
Amendments to Regulation SHO

Dear Ms. Morris:

Wolverine Trading, LLC (“Wolverine”) welcomes this opportunity to comment on the Securities and Exchange Commission’s (the “Commission”) release proposing certain amendments (the “Proposed Amendments”) to Rules 200 and 203 of Regulation SHO (Release No. 34-54154; File No. S7-12-06, referred to herein as the “Release”).

Wolverine is a proprietary trading firm that is registered with the Securities and Exchange Commission as a broker-dealer. Wolverine is one of the largest market making firms and it makes markets in the majority of listed index and equity options in the U.S. Wolverine is a member of, and registered as an options market maker on, the American Stock Exchange, the Boston Options Exchange, the Chicago Board Options Exchange, the International Securities Exchange, NYSE Arca, Inc. and the Philadelphia Stock Exchange.¹ As part of its options market making responsibilities, Wolverine acts as a designated primary market maker, lead market maker, specialist and market maker with a physical presence on the trading floors of the various options exchanges. Wolverine also makes markets remotely from off the trading floor as an electronic designated primary market maker, a competitive market maker and a remote market maker on the various options exchanges.

As the Commission no doubt is aware, Wolverine has many obligations as a market maker. A market maker creates liquidity by promoting a bid and ask price for, among other things, an underlying security (e.g., a listed stock) or an overlying derivative product (e.g., a listed option). Market makers also maintain fair, competitive, orderly and efficient markets. Depending upon the capacity in which a market maker is registered, it may be required to disseminate bids and offers continuously throughout the trading day

¹ Wolverine also is a member of the Chicago Board of Trade, the Chicago Mercantile Exchange, the Chicago Stock Exchange and the New York Commodities Exchange.

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and honor its bids and offers when orders are sent to trade against those quotes. Certain market makers also may handle customer orders on behalf of other broker dealers for execution at the best possible prices. Market makers frequently buy, sell and sell short equity stocks to hedge transactions entered into as a result of their options market making activity.

Short selling involves selling a share or shares of stock that the seller does not own. In order to effect a short sale, the short seller – with certain exceptions – must first locate or borrow the shares of stock to deliver to the buyer on the other side of the short sale transaction. At a later point in time, the short seller covers the short position by purchasing shares of stock in the open market – theoretically at a price lower than that at which the short seller initially borrowed the shares – and returning the shares to the stock lender. Short selling serves an important purpose in the market. Because not all companies are profitable, well capitalized, well managed and/or successful, downward pressure on those shares – from both long and short sales – serves to ensure that they are not overvalued in the open market.

In the Release, the Commission indicated that it intends to further amend its short sale regulations. The Commission indicated that the Proposed Amendments would reduce the number of fails to deliver in certain equity securities through the elimination of the grandfather provision and the narrowing of the options market maker exception. As the Commission noted in the Release, Regulation SHO became effective in January 2005 and was created in part to: (i) establish a close-out requirement to address problems with failure to deliver stock; and (ii) target abusive “naked” short selling (selling short without having the stock available for delivery and intentionally failing to deliver stock within the standard three-day settlement period). The Commission also indicated in the Release that based on statistics compiled by the National Securities Clearing Corporation, only 1% of the combined total equity, debt and municipal securities fail to settle and that the vast majority of these fails are closed out within five days of T+3. Further, the Commission noted that it believes that Reg SHO “has achieved substantial results” since it became effective and that it “appears to be significantly reducing fails to deliver without disruption to the market.” It would appear that based on these statistics and comments, Reg SHO already has accomplished one of the Commission’s primary goals in enacting the rule (i.e., reducing fails).

Wolverine believes that further changes to short sale regulations, and the Proposed Amendments in particular, will impact its ability to continue to provide liquidity in options overlying less active stocks and those stocks that are considered threshold securities.² Wolverine regularly relies on the market maker exceptions contained in Reg

² A threshold security is defined in Rule 203(c)(6) as any equity security of an issuer that is registered pursuant to section 12 of the Exchange Act or for which the issuer is required to file reports pursuant to section 15(d) of the Exchange Act for which there is an aggregate fail to deliver position for five

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SHO. Presently, Wolverine is able to hedge options trades by selling shares short without first locating stock and generally is not subject to the mandatory close-out requirements for threshold securities. These exceptions allow Wolverine to continuously disseminate bids and offers (i.e., be on both sides of the market) because it can easily hedge market maker option trades with stocks that are illiquid and/or considered “hard to borrow.”

Currently, market makers are excepted from mandatory close-out requirements for short sales effected to hedge option positions that were created before a security became a threshold security. The Commission has proposed to amend the market maker exception by requiring the close-out of any previously excepted fail to deliver positions that were established to hedge an option position that has expired or been closed-out. Based on Wolverine’s approach to options trading and risk management, however, we believe that this approach to determining which securities must be closed out is overly simplistic and does not reflect the way that market makers manage risk. Generally, we view risk based on the entire portfolio of our positions. Accordingly, once shares are bought or sold to hedge an option trade, the entire portfolio is balanced. When that original option position expires or is closed out, Wolverine may or may not need to buy or sell shares of stock to bring the position back into balance.

Wolverine also frequently provides liquidity to customers that are “rolling” positions from one expiration month into the next. When it participates in such trades, Wolverine’s current option position typically is closed out and the same position is opened in the next expiration month. Although Wolverine technically has closed out its original option position, it has opened up the same position in following month – and the original hedge might still be sufficient to maintain the balance of the portfolio. In threshold securities, however, under the proposed rule change, Wolverine would be required to close out any fails resulting from the original hedge. Furthermore, it then would have to turn around and reestablish the hedge, paying fees and other costs associated with hedging the rolled position. This clearly is inefficient and results in unnecessary costs.

Finally, because of the way Wolverine views risk and based on the volume of trades executed by Wolverine, Wolverine believes that it would be difficult to determine which stock trades were associated with which expiring or closed out option positions. However, we would note that as Wolverine’s option positions expire or are closed out, Wolverine reduces its stock positions as necessary and generally does not maintain excess stock positions that are not hedging the portfolio.

consecutive settlement days at a registered clearing agency of 10,000 shares or more, and that is equal to at least 0.5% of the issue’s total shares outstanding; and is included on a list disseminated to its members by a self-regulatory organization.

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If the Commission were to enact the proposed changes to Reg SHO as they apply to both grandfathering and the market maker exception, Wolverine is concerned that if all deliveries must be made within a specified period of time once a stock is classified as a threshold security, short sellers (both market makers and other market participants) undoubtedly will be “squeezed” into paying more to cover their short stock positions.³ This type of “squeeze” provides a misleading impression of the true state of the market and is no less manipulative or costly than “abusive ‘naked’ short selling.”

Because of its concerns related to the above, Wolverine believes that if the Commission were to enact the Proposed Amendments, Wolverine would be limited in the liquidity it could provide in options overlying both illiquid stocks (e.g., those that eventually may become threshold securities) and stocks that already are classified as threshold securities. While this is not something we would have preferred, Wolverine is not willing to assume risk outside of its established parameters on the short side or the long side of the market. Accordingly, if we are unable to sell stock short to hedge long option positions because of the costs associated with mandatory close-outs of our short stock positions, Wolverine likely would either withdraw as a market maker in those options or increase its quote spreads in those options to account for the increased costs of hedging its long option positions. In either case, members of the investing public will bear the brunt of the negative effects of the changes.

The Commission has to strike a balance between protecting market participants and allowing market forces to establish prices – on both the long and short sides of the market. The Proposed Amendments will act to further restrict short selling and therefore, could potentially result in overvalued stocks in the market and a substantial reduction in the ability of market participants to effect transactions in the options overlying illiquid stocks. If the Commission’s goal is to prevent “abusive ‘naked’ short selling,” we believe that changing the rules as they relate to market makers misses the mark.

³ Furthermore, this type of manipulative activity would be magnified if a mandatory close-out period is limited in duration (e.g., within tens days of T+3).

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Wolverine appreciates the opportunity to comment on the important issues raised by the Release. Wolverine believes that no amendments to Reg SHO are necessary at this time and that the current regulations sufficiently limit fails in threshold securities.

Very truly yours,

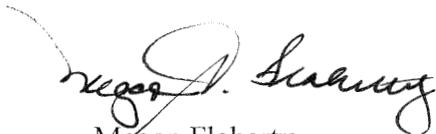
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