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Securities and Exchange Commission
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Washington, DC 20549

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Mr. Chairman, Members of the Commission Staff

I welcome this opportunity to respond to this critical proposal put before the public. The occasion to discuss the issues of member exemptions from standard securities laws is long overdue. I hope that by the end of this comment period the Commission is provided with the full perspective of where the public's perceptions to market making exemptions not just in the options market but also throughout the capital markets.

Background:

For decades rules have been in place that have allowed members of the industry to create liquidity in our capital markets through a process known as bona-fide market making. The intent was to make our markets free for investors to move in and out of intended holdings without restriction and to prevent possible manipulative trading by investors.

Wall Street professionals and "involved" retail investors have knowledge of the allowances regulators have provided the members who participate in the bona-fide market making business under Federal Securities rules. Yet, with more than 93 Million investors in these public markets only a very small percentage is fully aware of and understands this special privilege. A walk down the street and a simply inquiry of a passerby would validate the lack of public awareness to the bona fide market making exemptions and specifically the allowance to sell what does not exist.

It is because such a majority is unaware of a market making exemption; it is imperative that the SEC approaches this concept cautiously and adjusts the conditions such exemptions are utilized based on the evolving trading practices of the markets. The goals should be to derive business practices that support the growth of the capital markets while maintaining investor protections. Never should rule making be derived where a small Industry population is provided access to exemptions that insure riskless investment.

Today, the market making exemptions, both equity and options, are being conducted under a protective umbrella that reduces or eliminates any risk to the members who utilize such trade executions. The result of lightly regulated venue is a growing concern that manipulation of the markets by these firms is taking place. The exemption used to create liquidity and protect against manipulation is instead creating the manipulation.

Discussion:

As the Commission pointed out in this proposal, investor confidence has become directly linked to the perception of abusive persistent failures in localized issuer markets. The perception of fraud and wrongdoing not only sends out a negative message against the members and the regulators responsible for policing the members but it also reflects negatively on the company being abused.

Public companies only have one shot at enticing an investor into their markets. If that investor loses money due to perceived fraud they will never re-invest in that market no matter what the circumstance. Markets that are already subject to limited investor interests are further limited when such investors lose money on perceived abuses. Others may not even come to the market because they see it as a no-win opportunity.

Suddenly the balance between supply and demand is skewed as investors are driven away.

Clearly the Options Market Making exemption is an area where negative perception and abuse is being recognized. Short sellers who can no longer short the equity market are simply moving their interests over to the options market and use the options market maker to short the equity market for them as a hedge to a Put the short seller purchased in the options market.

With a short seller purchasing a Put the options market maker will hedge the sale with a short into the equity market and, in today's environment they do so with the exemption from settlement. Smart short sellers have used this knowledge of market operations to effectively have the options market maker saturate the demand side of the equity market with exemptive short sales ultimately driving the market into 'in the money' profits for the short seller.

This investment strategy being used results in a riskless investment by the options market maker and a profit by manipulation to the short seller. Under present rules, the exemptive short sales have no required timeline for closure and thus the next round of options contracts and exemptive hedging can be used to drive those hedged positions into the money before such trades are finally settled. The public issuer and investor come out the loser.

I believe that the SEC has become aware of this abuse by wealthy and powerful investors, as they have used the options market making exemption as their special weapon. With the perception that market making is a riskless business the short seller and market maker are working together to drive profit out of the equity investor in the markets.

Further, I believe that the SEC is fully aware of the securities violations presently taking place where options market makers have continued to use the exemption on contracts created after a company has reached threshold status. The evidence of such awareness is clearly documented in the language of this proposal leaving the only open question as to where the SEC enforcement cases are pertaining to these violations.

The catch-22 with any regulatory actions to be undertaken, they are generally handled as compliance violations and thus the impact such violations had on the issuer market is not a factor in the fines imposed. An Option market maker can fail to close out fails as required and the SEC enforcement teams will address this as a procedural issue that needs to be addressed. The fines imposed are frequently below $50,000 and a commitment to add further supervision.

Regulators frequently fail to address the cost avoidance at the firm through this indiscretion. Going into a market and purchasing guaranteed delivery for closure may have created a loss where the delay in taking appropriate steps created profit of at least a break even.

I believe that in March of 2004 the SEC Division of Market Regulation was provided such insight to how members were closing out fails when, through a proposal submitted by the NASD, the NASD used specific language in addressing such close outs. In the proposal submitted to the SEC Division of Market regulation the NASD stipulated that cost could not be used as a factor when addressing why a trade could not be settled after an accepted period of delay.

That proposal submitted, and the language contained therein was not put out for public proposal by the Commission staff but instead returned to the NASD. The Division of Market Regulation instead creating a federal level proposal that contained open ended language to the closing out of fails and created the ill-conceived grandfather clause.

Manipulation in a Bear Market:

The SEC's Office of Economic Analysis published a document on August 21, 2006 addressing the pre v. post performance of Regulation SHO. In that document the OEA stated that

- The average daily aggregate fails to deliver declined by 34.0% after the effective date of Regulation SHO.
- The average daily number of fails to deliver positions declined by 15.3%.
- The average daily number of threshold securities declined by 38.2% from the pre-to post-rule periods.

This study, as has been pointed out in the past, was flawed in its methods of averaging data. The raw data had instead indicated that the total level of Fails to Deliver, and companies with persistent fails to deliver was on a significant increase after November 2005 as the Capital Markets began a Bull run. Ironically, this study was updated for this proposal and while the flaw in the analysis remains, the data shows a reversing of the trend as the success numbers shown in August are now lower in March 2007..

These levels continued to increase into 2006 and more so into 2007 when the Bull Market turned Bear. As the level of short sales were on the rise, so too were the settlement failures. The problem the regulators face is that while the public has seen monthly compliance actions taken against these firms who abused the short sale process, our investments and our financial security were seeing risk unaccounted for. Fraud was being minimized into mere compliance violations. (Ref: NASD and NYSE Monthly Enforcement Logs)

Recent numbers on threshold securities over the month of August 2007 indicate a substantial increase in companies listed taking place as the market volatility has also increased. Where market makers are provided exemption to lower market volatility what has been seen is greater volatility and greater level of fails as the markets collapse under the Bear.

Consider that in January 2005 the first threshold security list contained 73 NYSE Companies and 102 NASDAQ companies. By October of 2005 those numbers were down to 39 and 79 respectively. On August 20, 2007 the NYSE had 120 companies listed (64% Increase from January 2005) while the NASDAQ was up to 162 Companies (59% Increase).

These increases during this Bear Markets are the indicators of a market problem. Somehow, during a time of great volatility, market declines, and increasing level of short interests the level of companies with persistent failures has skyrocketed. Sell side markets featured off shares that can not settle are exploding at a time where sell side interests in general are at their highest.

These failures can only be attributed to two venues. These are associated with the exemptions provided to market making or these are due to blatant naked shorting abuses. Present laws excuse one activity while the second is excused by the delays that come through a regulatory action.

Regulation SHO was never thought trough regarding a Bear market. The members they lobbied seduced the SEC into believing that honor and integrity would be brought back to these capital markets. The SEC blinked and denied the investing public with the language necessary in our laws to protect us from integrity lapses.

Response to Questions:

1. *Should market makers in the options markets be permitted to maintain a fail to deliver position in a threshold security for an extended period of time or indefinitely when market makers in the equities markets are not able to do so?*

   No. An option market maker makes a market based on supply and demand and they have the ability to set pricing of options contracts based on such demand. They must also set pricing based on risks they are willing to take. By allowing indefinite periods in time to close out the fail to deliver position you have allowed the market maker to take zero risk in selling unlimited quantities of contracts – or worse become the tool used to manipulate markets.

2. *Would elimination of the options market maker exception be appropriate? If so, why? If not, why not? Would elimination of the options market maker exception result in fewer options on threshold securities and what effect would this have on market efficiency and capital formation? Would eliminating the exception reduce the willingness of options market makers to make markets in securities that might become threshold securities or that are threshold securities?*

   To answer this question the SEC must consider where their priorities lie. Does the exemption on threshold securities allow short sellers who can no longer sell short the equity a means of shorting through the options market without the need for a locate and borrow? Is the protection of the pricing of the underlying equity the SEC's priority or is the right for an options market maker to profit the priority of the agency? Is there market efficiency when the offers represented are for shares that do not exist thus disturbing the process of equity buy-ins?

   Today buy-ins fail on threshold and non-threshold equities because members go into the market seeking shares only to be informed that no shares exist to purchase. Reality is, no shares exist at the pricing levels marked off shares exempt from settlement. Does the SEC consider this efficiency?

3. *Based on current experience with Regulation SHO, what have been the costs and benefits of the current options market maker exception?*

   Costs and benefits to whom? The SEC repeatedly seeks out the costs of member firms to come into compliance to proposed rules. What efforts has the SEC undertaken to understand the costs to investors in not implementing appropriate rules? As the SEC factors in costs, do market cap losses to public companies and investors get factored in? Does the loss of contracts or the dissolution of a business get factored in as the market cap losses hinder business development and growth?

   I ask the Commission to fully explore whose cost and benefits they are considering with such frequency of this question. What percentage of the investing public engage in the options market and what percentage engage in trading that would require the options market maker to hedge a trade by selling short the equities market?

4. *What kind of a phase in period would be necessary?*

   Due to the length of delay by the Commission staff, and the frequency in which the Commission's Division of Market Regulations addresses the members in seeking out a rule change, the 35 Calendar days is more than adequate time. Delays beyond that are putting the needs of potential abuses above that of the needs of the investing public.

In 2004 when the SEC created Regulation SHO the SEC provided 6 months for member firms to come into compliance. They also provided these members with opportunity to begin to alter their abusive ways. Instead, the level of fails rose to their highest levels in December of 2004 and many of the Tier I firms never funded their operations appropriately to create compliance procedures (Ref NYSE Fines for SHO Violations). Instead, as firms like Goldman Sachs were reaping record profits and dolling out billions in bonuses they were minimizing their efforts to meet the new regulatory standards. It was a risk v. reward decision made by these firms.

Clearly it does not matter how long you provide these firms, history has shown that little efforts will be made until the auditors come calling. As such, why provide delays that will only be used to load the boat on more abuses?

Conclusions:

I could provide continued chapter and verse on this subject as to why the market making exemption, in both equity and options trading, must be looked at closely by the Commission and reduced significantly. As a retail investor I am becoming more and more aware such chapter and verse is really not appreciated by the Commission staff as it is really the opinions of Wall Street that you are seeking answers from. Your private meetings with member firms and their lobbyist, and closed-door agreements these past 4 years, have demonstrated a lack of appreciation for the responses you receive from the general public. I would urge that if the Commission does hold such meetings on this reform that the Commission take the notes such that the public has access to those discussions under FOIA. Avoiding the notes to circumvent the FOIA process is as unethical as anything the SEC can charge others for,

As for this proposal, the reality is the exemptions these members want are not needed for liquidity purposes any more as hedge funds have come in to replace such needs. Trading volumes and short sale activities are at their highs implying that investors are freely being provided the access to get into or out of their holdings. Exemptions are thus being used merely as a tool to guarantee profits for these firms as if profits must be a guarantee the Commission apparently provides.

The SEC's recent actions pertaining to the short sale process has clearly drawn a line in the sand between investor and member firms. The grandfather clause was a major gaffe and we are now seeing the ramifications of the elimination of a 70 year protection called the uptick rule. With the continued efforts to protect market makers business by allowing unlimited fails for indefinite periods in time the Commission has failed to recognize what such exemptions have on the business model of the underlying equity being oversold.

The SEC gave Options market makers a chance and they abused such opportunities. Fails are at their greatest levels since January 2005 when SHO was created and those fails have come at the expense of the public and at the profit of localized few.

It is time the Division of Market Regulation came back to neutral on this subject and stopped protecting the crooks that have been given a free pass to abuse.

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